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# REGULATORY REFORM INITIATIVES

## HEARINGS

BEFORE THE

## COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

REGULATION THROUGH NEGOTIATION:
THE NEGOTIATED RULEMAKING ACT
MAY 13, 1988

REGULATORY REFORM: FEDERALISM AND THE
REGULATORY FLEXIBILITY ACT
SEPTEMBER 14, 1988

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# CONTENTS

Opening statements: Page
- Senator Glenn 1, 29, 81
- Senator Levin 2, 49
- Senator Sasser 4
- Senator Heinz 53

## WITNESSES

### Friday, May 13, 1988

Marshall Breger, Chairman, Administrative Conference of the United States, accompanied by David Pritzker, attorney 5
Thomas E. Kelly, Director, Office of Standards and Regulations, Office of Policy, Planning and Evaluation, Environmental Protection Agency, accompanied by Chris Kirtz, Director, Regulatory Negotiation Project 7
Philip Harter, attorney at law, Washington, DC 10
Kelly M. Brown, executive engineer, Fuel Economy, Emissions, and Noise Control Program, Ford Motor Co 12
David D. Doniger, senior staff attorney, Natural Resources Defense Council 15
David F. Zoll, vice president and general counsel, Chemical Manufacturers Association 17

### Wednesday, September 14, 1988

Jonathan Lash, secretary, Agency of Natural Resources, State of Vermont 31
Jeffrey H. Schiff, executive director, National Association of Towns & Townships 36
Joan L. Beardmore, clerk, Warren Township, Washington County, OH 41
Jeffrey L. Leiter, small business representative, Collier, Shannon, Rill & Scott 44
Frank A. Swain, Chief Counsel for Advocacy, Small Business Administration 60
Richard D. Morgenstern, Director, Office of Policy Analysis, Environmental Protection Agency, accompanied by Louise Jacobs, Chief Counsel for Advocacy 64
Elliot Schwartz, Acting Assistant Director for National Resources and Commerce Division, Congressional Budget Office, accompanied by Roger Dower, Chief, Energy and Environment Group, and Frances Sussman, staff member 74

### Monday, October 3, 1988

Joan Claybrook, president, Public Citizen Litigation Group, Washington, DC, accompanied by David Vladeck, senior attorney 83
Richard A. Wegman, partner, Wegman & Hoff, Washington, DC 87
W. Kip Viscusi, George G. Allen professor of economics, Duke University 91
Jay Plager, Administrator, Office of Information and Regulatory Policy, Office of Management and Budget 102

### Alphabetical List of Witnesses

Beardmore, Joan L.:
- Testimony 41
- Prepared statement 274
- Response to written question submitted by Senator Glenn 281

Page
Breger, Marshall:
  Testimony .......... 5
  Prepared statement .......... 132
  Responses to written questions submitted by Senator Glenn .......... 142
Brown, Kelly M.:
  Testimony .......... 12
  Prepared statement .......... 202
Claybrook, Joan:
  Testimony .......... 83
  Prepared statement .......... 360
  Responses to written questions submitted by Senator Glenn and Senator Levin .......... 376
Doniger, David D.:
  Testimony .......... 15
  Prepared statement with an attachment .......... 209
Dower, Roger: Testimony .......... 74
Harter, Philip:
  Testimony .......... 10
  Prepared statement with a supplement .......... 182
Jacobs, Louise: Testimony .......... 64
Kelly, Thomas E.:
  Testimony .......... 7
  Prepared statement with attachments .......... 144
  Responses to written questions submitted by Senator Sasser .......... 181
Kirtz, Chris: Testimony .......... 7
Lash, Jonathan:
  Testimony .......... 31
  Prepared statement with an attachment .......... 242
  Responses to written questions submitted by Senator Glenn .......... 250
Leiter, Jeffrey L.:
  Testimony .......... 44
  Prepared statement .......... 283
Morgenstern, Richard D.:
  Testimony .......... 64
  Prepared statement .......... 324
  Responses to written questions submitted by:
    Senator Glenn .......... 341
    Senator Levin .......... 343
    Senator Sasser .......... 344
    Senator Heinz .......... 348
Plager, Jay:
  Testimony .......... 102
  Prepared statement .......... 412
  Responses to written questions submitted by:
    Senator Glenn .......... 431
    Senator Levin .......... 436
  Letter to Senator Glenn, November 16, 1988 .......... 438
Pritzker, David: Testimony .......... 5
Schiff, Jeffrey H.:
  Testimony .......... 36
  Prepared statement with an attachment .......... 255
  Responses to written questions submitted by:
    Senator Glenn .......... 266
    Senator Levin .......... 266
Schwartz, Elliot:
  Testimony .......... 74
  Prepared statement .......... 350
  Responses to written questions submitted by Senator Glenn .......... 358
Sussman, Frances: Testimony .......... 74
Swain, Frank:
  Testimony .......... 60
  Prepared statement .......... 295
  Responses to written questions submitted by:
    Senator Glenn .......... 316
    Senator Levin .......... 321
Viscusi, W. Kip:
  Testimony .......... 91
  Prepared statement .......... 401

Page
Viscusi, W. Kip—Continued
  Responses to written questions submitted by Senator Glenn ........ 408
Vladeck, David: Testimony ........ 83
Wegman, Richard A.:
  Testimony ........ 87
  Prepared statement ........ 384
  Responses to written questions submitted by Senator Glenn ........ 398
Zoll, David F.:
  Testimony ........ 17
  Prepared statement ........ 223

## APPENDIX

Text of S. 1504 ........ 115
Prepared statements and responses to written questions of witnesses in order of appearance ........ 132
Statements and letters from:
  Administrative Conference of the United States ........ 442
  American Federation of Labor and Congress of Industrial Organizations ... 460
  Conflict Clinic, Inc ........ 464
  Conservation Foundation ........ 466
  Dunlop, John T., Lamont University professor, emeritus, Harvard University ........ 472
  Industrial Safety Equipment Association ........ 481
  Jefferson Group ........ 490
  National Association of Manufacturers ........ 492
  Office of Management and Budget ........ 494
  Susskind, Prof. Lawrence ........ 496
  U.S. Chamber of Commerce ........ 498
"Environmental Federalism," by Robert M. Schwab, from Resources, summer of 1988 ........ 499
"Environmental Federalism: Allocating Responsibilities for Environmental Protection," staff working paper, Congressional Budget Office, September 1988 ........ 503
"Municipalities, Small Business, and Agriculture: The Challenge of Meeting Environmental Responsibilities," Office of Policy Planning and Evaluation, U.S. Environmental Protection Agency, September 1988 ........ 552
"Presidential Oversight: Controlling the Regulators," by W. Kip Viscusi, from the Journal of Policy Analysis and Management, 1983 ........ 636
"Regulatory Program of the United States Government," Office of Management and Budget, April 1, 1988—March 31, 1989 ........ 653
"Regulatory Relief Program for Small Communities," National Association of Towns & Townships, October 6, 1987 ........ 704

# REGULATION THROUGH NEGOTIATION: THE NEGOTIATED RULEMAKING ACT

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FRIDAY, MAY 13, 1988

U.S. Senate,
Committee on Governmental Affairs,
*Washington, DC.*

The Committee met, pursuant to notice, at 9:35 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn and Levin.

## OPENING STATEMENT OF CHAIRMAN GLENN

Chairman **Glenn**. The hearing will be in order.

Today the Committee begins the first in a series of hearings it will hold on a variety of issues related to regulatory reform. As many of you may recall, a little bit more than a decade ago, pursuant to a Senate resolution, this Committee undertook a comprehenaisve assessment of the status of Federal regulation, examined the impact of contemporary regulatory programs, and suggested areas for change. And I believe that we have not fully recognized the result of those hearings. The output from that study was a seven-volume Committee report that over the years has been an invaluable resource to policy-makers, to industry, to public interest groups, and to scholars.

Needless to say, the last decade has witnessed a virtual revolution both in the way the Federal Government regulates and in the substance of its regulatory policies themselves. During this period, not only have policies of deregulation been pursued, but the Congress and the President have sought ways to reduce the cost and burden of regulation where it is warranted. It is fair to say that, while there is agreement that only necessary and cost-effective regulation should be implemented or maintained, the Congress and the President have been unable to agree on how best to achieve that goal. It is against this backdrop that I have scheduled these hearings. It is a propitious time to "take stock" of our initiatives in regulatory reform.

Today we focus on "new" *methods* of regulation; in particular, on a form of "alternative means of dispute resolution"—or ADRs, as they have become known—negotiated rulemaking, as embodied in S. 1504, the Negotiated Rulemaking Act. S. 1504 was introduced by my colleague on the Committee, Senator Levin, and I commend him for his leadership in this area. He really has pushed this. It is not one of the racy headline issues of Government, but it is one of the most important things that we have to consider if we are going to make regulatory reform work and work correctly. I am not simply talking about rhetoric out of the White House or out of some of the departments about turning functions back to the people. I am talking about seriously considering how to make the regulatory process work the way it should.

Carl Levin deserves much credit because he has worked on this issue and studied it. He has examined it on the Subcommittee, and we are glad to have a meeting today that will give him the forum of the full Committee to address the subject on which he has done a lot of work over the past 2 years. We are happy to do that.

Negotiated rulemaking, sometimes called regulatory negotiation—or the shorthand for it is "reg neg"—is a process by which an agency develops a rule through convening a committee comprised of representatives of the affected interests. The basic principle is that if these representatives sit down together and make a commitment to find areas of agreement, regulations can be fashioned which are less susceptible to challenge, because the affected parties have participated in the rules development and have a stake in their success.

This approach presents an alternative to the conventional rulemaking procedure which, under some circumstances, may encourage the affected groups as well as the involved agency to adopt extreme positions and adversarial relationships with respect to the rules being developed. Thus, where it is better suited than conventional rulemaking, negotiated rulemaking holds out the promise that excessive litigation and its attendant administrative and social costs can be reduced. S. 1504 develops a basic framework for implementation of negotiated rulemaking in line with the strictures of the Federal Advisory Committee Act (FACA) and facilitate agency use of the procedure.

This morning we have two panels of distinguished witnesses, and we look forward to their testimony. On the first panel, we have Marshall Breger, who is Chairman of the Administrative Conference of the United States. Also on this first panel is Thomas Kelly, who is Director of the Office of Standards and Regulations at EPA.

On the second panel, we have Philip Harter, who is an attorney in private practice here in Washington; Kelly Brown from Ford Motor Company; David Doniger, who is with the Natural Resources Defense Council; and David Zoll, who represents the Chemical Manufacturers Association.

We welcome you all to the hearing this morning. Once again, I want to give full credit where credit is due. Carl Levin has been the leader looking into this issue. It is an important issue concerning the way Government functions and it is of vital concern to this Committee. We appreciate his leadership on this. Carl?

## OPENING STATEMENT OF SENATOR LEVIN

Senator **Levin**. Thank you very much, Senator Glenn. You are the one to be congratualted for your initiative in scheduling a series of hearings on regulatory reform. Under your leadership, this Committee is addressing, in the nuts-and-bolts fashion that you are so famous for, getting things done to help our Government work better. It is not always the glitziest subject, as you mentioned, but it is a very important subject. Your dedication to the improvement of Government operations is, indeed, critical, and your leadership in this area is really impressive. I thank you for it.

The bill which is the subject of today's hearing, which is the first of a series on regulatory reform, is S. 1504, as you have mentioned. It contains what was once a novel proposal, a process to encourage agencies to use negotiated rulemaking. It was novel back in 1980 when I first introduced a similar bill. Today, it is no longer novel; the negotiated rulemaking process has been tried and proven effective. I hope that we will pass this bill, with any necessary improvements, of course, and thereby put the machinery in place that will encourage more agencies to try negotiated rulemaking.

Negotiated rulemaking, or "reg neg" as the veterans of this process call it, is a rulemaking device designed to achieve consensus among competing interests in a controversial agency rulemaking. Reg neg is a process where the parties that will be significantly affected by an agency rule sit down together and try to negotiate in good faith to develop the elements of a rule that they can live with. If the parties are successful in reaching agreement on a draft rule, the draft is given to the agency with the expectation that the agency will use it as the basis for publishing a proposed rule in the Federal Register.

The benefits of this process are readily apparent. Instead of affected parties spending their time and resources litigating a rule drafted and imposed by an agency, the affected parties and the agency spend their time and energies constructively developing a proposed rule together. The parties acquire a proprietary interest in that proposed rule and, as a result, are more likely to defend than to challenge it when it is published for comment. The rule may also be a better rule, substantively, since it will reflect the involvement of knowledgeable persons who are directly affected by it. Moreover, a negotiated rule is likely to become effective earlier than a rule developed through ordinary rulemaking procedures.

S. 1504 lays out the basic framework for conducting a negotiated rulemaking when an agency decides to employ that process. It seeks to achieve the twin goals of providing sufficient guidance to agencies to encourage their use of the process, while building in mechanisms for the procedural flexibility which is the hallmark of the negotiated rulemaking process. The bill assigns to the Administrative Conference of the United States the responsibility to act as a clearinghouse for information and assistance.

Under the bill, an agency decides whether to engage in a negotiated rulemaking. As I think we will hear today, the negotiated rulemaking process will not work in all or even a majority of rulemaking situations, and its success depends on the degree of care exercised in selecting the cases in which it is employed. S. 1504 requires consideration of such factors as whether there are a limited number of identifiable parties who will be significantly affected by the rule, the likelihood that consensus will be reached on a rule, and whether the agency is willing to use such consensus as the basis for publishing a proposed rule. I think we will hear testimony today about the importance of considering these and other factors in deciding whether to use negotiated rulemaking.

If an agency decides to use the process, under the bill, it would establish a rulemaking advisory committee with representatives from the agency and the affected interests. The advisory committee would be chartered and operate under the provisions of FACA, the Federal Advisory Committee Act, to assure openness, proper record-keeping and cost controls. The rulemaking committee would conduct its negotiations under the auspices of an impartial mediator who would assist the parties in reaching consensus. If the parties achieve consensus on a draft rule, they would present their recommendations to the agency. The agency would then decide whether to publish in the Federal Register a proposed rule based on the committee's consensus, under existing procedures for public notice and comment. If the parties do not reach agreement on a rule, they would file a report describing any issues they were able to resolve, as well as the unresolved issues.

As I mentioned earlier, S. 1504 is not the first bill this Committee has considered to foster negotiated rulemaking. A number of us first introduced a bill in September of 1980. Similar bills were introduced in the last three Congresses. Unfortunately, those bills did not get reported out of Committee because, I suspect, the process may have been considered too novel or unproven. In the meantime, EPA, FAA, OSHA and several other agencies have conducted negotiated rulemakings which demonstrate that, not only is the process feasible, it can be a viable and effective tool.

I look forward today, as the Chairman and other members of the Committee do, to today's witnesses, to hear their testimony about their experience with this no longer novel process.

Senator Sasser is unable to be here today and he has a statement for the record that will be inserted into the record at this time.

[Senator Sasser's statement follows:]

## OPENING STATEMENT OF SENATOR SASSER

Thank you, Mr. Chairman. I commend you holding this first hearing in a series conducted by the Committee on Governmental Affairs concerning regulatory reform. The hearing today examines the practice of negotiated rulemaking and legislation designed to formalize the process, S. 1504.

The concept of negotiated rulemaking is an innovative one, especially for those agencies, like the Environmental Protection Agency, where rulemaking has become such an adversarial process, engendering significant numbers of costly and time-consuming lawsuits.

The concept of the face-to-face negotiations that negotiated rulemaking entails may be far more productive than negotiations conducted through the Federal Register and in court. It would seem from the experience that we have with negotiated rulemaking that it can be more effective than the traditional rulemaking procedure that has evolved within the Federal Government.

Indeed, negotiated rulemaking may have considerable promise in that it could eliminate needless controversy surrounding the rulemaking process. Even if a consensus is not reached as a result of the negotiations, they provide a valuable opportunity for an exchange of views and information on the proposed rule. And the process seems to pull both sides of an issue away from extreme adversarial positions, and more toward a compromise.

The experience of the Environmental Protection Agency, the Federal Aviation Administration, and the Occupational Health and Safety Administration, among others, should serve as a guide for other agencies as they begin to attempt this alternative negotiations process.

The delay that results from the litigation that often surrounds traditional rulemaking in some cases significantly interferes with the business of regulation, and, of course such litigation burdens the judiciary which finds it exceedingly difficult to make the sorts of technical determinations which are at the heart of these lawsuits.

Of course, the Federal Government does not yet have extensive experience with this "reg neg" process, and therefore, agencies are understandably hesitant to conduct this important component of their business in a different and perhaps slightly unpredictable atmosphere. But I feel certain that as they gain experience in the process, it may come to be used more and more—and with good results.

S. 1504 may well provide the support and guidance needed to encourage greater use of this process. S. 1504 proposes a constructive framework within which the negotiated rulemaking can occur.

I look forward to hearing testimony on this procedure and the bill from such a diverse and distinguished group of witnesses.

Thank you, Mr. Chairman.

Senator LEVIN. Our first panel, as our Chairman mentioned, is Marshall Breger, Chairman of the Administrative Conference of the United States, accompanied by David Pritzker, and Thomas Kelly, Director of the Office of Standards and Regulations of the Office of Policy, Planning and Evaulation of the EPA. He is accompanied by Chris Kirtz, who is the Director of the Regulatory Negotiation Project of the EPA.

We would appreciate your summarized testimony. You are all pros and experts at this process. We have a particular problem this morning because the defense bill is on the floor. Both the Chairman and I have to be on the floor this morning, not just to vote but to participate in an amendment. So it is going to be a little bit helter-skelter here this morning. So to the extent you are able to boil down your testimony, we would greatly appreciate it.

Mr. BREGER, I guess we start with you.

## TESTIMONY OF MARSHALL BREGER, CHAIRMAN, ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, ACCOMPANIED BY DAVID PRITZKER, ATTORNEY

Mr. BREGER. Thank you very much, Mr. Chairman. I would ask that my written remarks be received in the record.[1]

Senator LEVIN. They will be.

Mr. BREGER. I am accompanied by David Pritzker, a staff attorney, our resident expert on reg neg.

I am delighted that this Committee is looking at the problem of reg neg as part of their series on regulatory reform because I think it takes into account the basic transformation of administrative law since the passage of the Administrative Procedure Act, the shift from adjudication to rulemaking as the main vehicle for policy articulation.

As you know, when the APA was first passed, there was very little thought given to rulemaking. There were two kinds of rulemaking: formal rulemaking on a record, which allowed for full hearing rights, cross-examination rights, participation by anyone and everyone under the sun. This proved so cumbersome it is only used now when a statute requires it; and informal rulemaking, by which you would make rules through a notice and comment process. The notice and comment process, many people were concerned did not give sufficient opportunity for public participation and involvement, and often set up adversary situations is contexts where they might not ultimately have been necessary.

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[1] See p. 132.

The exploration of reg neg, as one of a series of refinements and improvements on informal rulemaking, is evidence of the fact that the actions in policy articulation in the administrative law area is in rulemaking and is in the search for better ways to improve rulemaking.

I think reg neg is an opportunity in many instances to improve the rulemaking process for two reasons: First, and this is almost tautological, you get a better rule when you bring together all of the affected and impacted parties for serious give and take. Even where the reg neg may fail, you still provide the agency with a great deal of valuable information and insight, which in a perfect world and in a perfect system, they would have been trying to secure in any event before moving forward with a rule. And, secondly, in many instances, you are able to prevent litigation after the rule is issued.

I have to point out that the culture or the context of rulemaking now cannot be thought of without taking litigation into account. Over three fourths of the EPA rules, I understand, are litigated. So what is supposed to be the end of a rational, intelligent and complex process—the creation of a rule—is, in fact, only the opening salvo, the opening volley in a long litigation process. You must put together rulemaking and litigation now because litigation has become one of the mechanisms of impacting upon agencies and impacting upon the rulemaking process.

Thirdly, the use of reg neg can reduce compliance costs, because once you have a better understanding throughout the affected community about a regulation and about its purposes and values, you are more likely to get voluntary, consensual compliance, and you will have a better ability to get compliance.

So we think that the reg neg device is an important one for these reasons, and we think that this bill will assist in encouraging agencies to take advantage of reg neg where appropriate and, in fact, to be blunt, will assist in consciousness-raising in a bureaucratic culture which, at times, is resistant to change and at times is resistant to the notion of bringing in public participation and involvement at the very beginning.

I am not a zealot. I recognize that reg neg will not always work. It should not be over-sold. It needs, in fact, continuous study to understand better the kinds of cases and situations where it will work. The process was, as you say, novel when you introduced your legislation in 1980. There have been a dozen or so, a few more reg negs tried since then. We still need a larger empirical base, and I am pleased that this legislation recognizes that it is a continuous process to understand where reg negs can be better made use of and implemented.

Finally, I would point out that the reg neg process does not suggest that the agency is supposed to sit back passively and simply take the result of an agreement between the affected and impacted parties. It is not situation where if the consumer groups and the industry groups can get together and sign a concord that the agency automatically jumps up and says terrific. The agency has to be an active part of a reg neg, protecting the public interest as it sees it. And it is because of the fact that the agency will be such an active part that the likelihood for success over the long term is increased.

Let me stop now, and I will be pleased to answer any questions you might have.

Senator LEVIN. Thank you, Mr. Breger, very much.

Mr. Kelly?

## TESTIMONY OF THOMAS E. KELLY, DIRECTOR, OFFICE OF STANDARDS AND REGULATIONS, OFFICE OF POLICY, PLANNING AND EVALUATION, ENVIRONMENTAL PROTECTION AGENCY,[1] ACCOMPANIED BY CHRIS KIRTZ, DIRECTOR, REGULATORY NEGOTIATION PROJECT

Mr. KELLY. Thank you, Senator Levin.

As the Director of Standards and Regulations for EPA, I am Chairman of our Regulatory Steering Committee, which is sort of a Ways and Means Committee for our traditional rulemaking. But I also have the responsibility for fostering and promoting regulatory negotiation and other innovative ways of solving regulatory problems affecting the environment.

I have with me Chris Kirtz, who has been Director of our Regulatory Negotiation Project for the past several years, and who was there at the wedding, so to speak, for each of the negotiations that we conducted so far. I am glad that he will be here to answer any specific questions you might have about our history in this area.

I listened very carefully to your comments, and I think it is fair to say that we at EPA have been inspired by the leadership that you have taken in bringing this need for better, less litigious ways of rulemaking to the front of our policy-making agenda. I also recognize that you may have gained from the experience that we have had in the Environmental Protection Agency and from some of the lessons that we have learned over the years.

You have my written testimony, and I am not going to take your time this morning to go back over that. But I do want to touch on a few points.

We have worked in EPA according to criteria that we think will help us choose rules that are most likely to succeed as negotiated rulemaking. In the past year, we conducted an evaluation of our experience to date. Mr. Irwin Auerbach of our Program Evaluation Division did what I thought was an extremely fine and objective job of going back over our recent history without trying to romanticize the issue, nor to be overly critical of the potential of regulatory neogtiations. We have included that report as our first attachment, and I would call your attention to it. I think it is an extremely rich source of lessons learned.

In listening to what you said, and from scanning some of the other testimony that has been prepared for today, it seems to me that we are in the process of negotiation here as we come back, year after year and we are beginning to form a consensus. Many of the points that Mr. Breger has just made to you and that I have read, quickly scanning some of the others, are points that I was prepared to make to you today. Regulatory negotiation is essential, we think, to get away from this "regulate, litigate, regulate, litigate" syndrome that we are into; but it is not always and it is not everywhere.

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[1] See p. 144 for Mr. Kelly's prepared statement.

As a matter of fact, our lessons learned are beginning to reveal the shape of the little corner of regulatory action that is appropriate for negotiation. And while it is small, I believe it is discrete, and the rules are becoming more and more clear as we go along.

Negotiating rules is very time-intensive, and to get the people around the table that we really need, we are finding that we have to go back to the same people over and over again. That is another factor that will constrain our ability to make this a "growth industry." So I have become fond of saying that regulatory negotiation is essential, but it is the flagship, not the fleet, of our regulatory work burden. And we think it is vital as a visible sign of EPA's interest in getting the contention out of our rulemaking process to the extent that we can.

We are finding that much of the benefit is in the spillover effects: the relationships, the good will, the ability to talk to people quietly and without contention about a lot of other matters that affect the regulatory agenda.

Our summary comment on S. 1504 is that it really is a very good idea. That is probably because we think it supports our agenda, and anything that supports what we are trying to do is a good idea, as far as we are concerned! We think that ACUS can play a very constructive role, and we are pleased to see them moving closer to a facilitative leadership role in this process. We think that the whole point of the bill ought to be to make it easier, to reduce the number of leaps and hurdles—some of them psychological, some of them administrative, some of them cultural—that Federal agencies have to take in order to enter what to many still seems to be a totally new area.

We recognize that regulatory negotiation cannot replace traditional rulemaking. I guess one concern I would have about the legislation is that it might tend to over-emphasize it and push people to try it where it may not work. That would be one caution that I would suggest to you. I think also the role of ACUS needs to be very carefully described so that burdens and obstacles are removed rather than raised in the process.

One last small comment. I did listen very carefully to your remarks, and you used the term "mediator" as the title of the individual who would be providing services within the course of a negotiation. In one of our technical comments, we point out that we think it important to identify that role as one of a "facilitator", because traditionally a mediator gets involved in active negotiation of issues. We think the facilitator needs to be neutral and work with the process and not the substance. Other than that and a few other suggestions, we think you have got a very good bill.

Thank you.

Senator LEVIN. Mr. Kelly, we thank you and Mr. Breger, both. We welcome your comments and your suggestions, many of which we happen to agree with and we can incorporate in the bill.

Mr. Breger, first, let me ask you how you would respond to the argument that some people are making, that we do not need a statutory framework, we do not need a law, because reg neg is still too new a process and because the agencies use reg neg, at least some agencies, without a statutory framework.

Mr. **Breger**. Our reading of the Federal Advisory Committee Act would allow agencies to develop regulatory negotiations without statutory change.

However, there are agencies that have taken a different position, and have said that they would require explicit statutory approval to enter into reg neg.

Secondly—and if I may say, as important—the explicit statutory approval takes away an important area of concern, uncertainty, and a prudential decision not to go into an area that might cause trouble, and makes it much easier for agencies that want to move forward with a reg neg to get permission to do so.

So that explicit statutory endorsement assists in overcoming a bureaucratic culture that may not be as sensitive to the need for the reg neg as people in this room. And I think that is, in a practical sense, is as important as the strict legal question.

Mr. **Pritzker**. Mr. Chairman, there has also been in some agencies a problem with consideration of up-front costs. the long-term savings, in terms of reduced compliance costs, and reduced expectation of need for litigation are not always easily balanced by the agencies against the up-front commitment of costs.

In addition, many participants, who are absolutely essential to make the process work, have said that the burden upon them is so intensive that they would need some assistance, and, clearly, the process is not going to work, without having represented at the negotiating table, representatives of all affected interests.

Therefore, the fact that this bill would provide a small but, in terms of the need, relatively large boost in financial assistance is something that would be very helpful in inducing agencies to proceed with it.

Senator **Levin**. What about the relationship with FACA? Is one of the useful aspects of this bill that it clarifies the FACA connection?

Mr. **Breger**. Very much so. As I said, many general counsels are concerned and worried about FACA exposure. People who are less enthusiastic about the reg neg will point to that as a reason why we should not go forward, or why one should not go forward. What this bill does is provide a level of comfort to those who are supportive of a reg neg, and reduces the objections, or the possibility of objections on the strictly legal grounds, the technical grounds of FACA exposure, by those who, in general, may not be sympathetic to the approach.

Senator **Levin**. Thank you. Mr. Kelly, just a few questions. If EPA decides to initiate a negotiated rulemaking, what kind of assurance do you give to participants that you'll likely use the rule that they draft in the proposed rule for publication?

Mr. **Kelly**. My understanding is that we give each participant our full assurance that the product of a consensus will be the basis of a proposal. When I say that, I want to make sure that that product of consensus is understood in the same sense that Mr. Breger described earlier—that the agency, EPA, which is representing the Federal interest, and which is ultimately responsible for the product of rulemaking, has to be a party to that consensus.

Senator LEVIN. What role do you believe an agency should play in furnishing technical data and other resources to participants in the negotiated rulemaking?

Mr. KELLY. My personal belief is that we ought to provide the negotiating committee with the full technical resources that we would make available to our own staff if we were operating under traditional rulemaking.

Senator LEVIN. In order that we can try to meet all of our commitments, we are going to stop there. We will probably have additional questions for the record for the witnesses. We appreciate very much your testimony, your support, the constructive suggestions for changes, and your willingness to participate.

Our second panel consists of Philip Harter, an attorney in Washington; Kelly Brown, executive engineer, Ford Motor Company; Dave Doniger who is a senior staff attorney with the Natural Resources Defense Council; and David Zoll, vice president and general counsel, the Chemical Manufacturers Association.

I do not know that there is any great logic to the order that their names are printed on this schedule. I will assume there is since our staff acts with such logic consistently, except when they do not, [laughter] so I will call on Mr. Harter first.

## TESTIMONY OF PHILIP HARTER, ATTORNEY AT LAW, WASHINGTON, DC [1]

Mr. HARTER. Thank you. I would like to begin by thanking you, Senator Levin, for your leadership in this whole area. My involvement in it really did begin as a result of the bill you introduced in 1980. I had long been interested and intrigued by the relationship between private efforts and Government regulation. I was firmly of the view that regulation could be improved by tapping the expertise of the private sector.

I thought your bill was an interesting approach. I wanted to analyze it a little more and meld it with traditional concepts of administration law, so I talked with the folks at the Administration Conference about that, and the report that I prepared for them and their recommendations resulted directly from that bill you had introduced. The bill we are addressing here is several evolutionary steps later.

Frankly, when I undertook that effort, I thought, rather firmly, that nobody would take it seriously. I thought it was probably too radical, too far out, too nontraditional as compared to the then-evolving hybrid rulemaking process.

But that the fact that we are here today is an acknowledgment that it has caught on and has been successfully proven.

In looking back over the ones that I have participated in, I think they have demonstrated that it is a powerful tool to address regulations that have a significant factual basis, but that are not driven by the facts—those in which if only you do enough research you will have an answer that will be codified in a regulation. But there are still complex factual matters that will also require a value judgment for their resolution. Moreover, there are other areas where for some reason or another, the rules have become politicized—they are controversial—and people are haggling and using all kinds of weapons to achieve their goal.

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[1] See p. 182 for Mr. Harter's prepared statement.

Basically, I think that is because the whole process is an adaptation of the legislative one, where representatives of the parties get together and work out a legislative accommodation. In this case, of course, it has to be against the backdrop of statutory requirements since the agency itself is not sovereign.

Overall, the success of that process in taking on those relatively large, complex rules, has been quite happy.

Even where the committee itself has not been successful in reaching an agreement—and there certainly have been several of those—the process really should be deemed a success. One does not measure the success of a regulatory negotiation only by a signed agreement at the end. For example, one of the most successful ones was by the FAA in developing its flight duty status time, a rule that had eluded revision for 20 years; every time they tried to revise it, somebody or another would shoot down the effort. The agency had had to issue 1,000 pages of complex "interpretations" because their rule was so complicated and controversial.

They empanelled a regulatory negotiation, and although they did not come to agreement, within a year the FAA had its new rule and from all reports it is working really quite successfully.

OSHA's benzene negotiations did not reach agreement. The agency itself missed its own deadline by 3 years, but it is interesting to note that benzene, once issued by OSHA, has become the first rule issued by that agency not to be subjected to judicial review.

Turning to the bill itself, it is important to emphasize—as has been done again, but we would hope that any report, or the bill itself—that agencies are authorized under current law to conduct these negotiations.

This is simply an explicit authorization since some agencies apparently remain nervous about the process—you have to piece together various strands of administrative law, and apparently some agencies either cannot find them, or are reluctant to make that kind of interpretation. Having a codified procedure may help overcome that reticence. The bill does an admirable job of capturing the best of current practice, and so I encourage it and applaud it for that reason.

It is also important, either in the bill itself or certainly in any accompanying Senate report, to emphasize that it does not foreclose experimentation with other procedures. I would hate to see a codification of this process foreclose other kinds of procedures that are currently authorized by law. For example, other uses of FACA, perhaps a slightly modified kind of process that does not conform to one or another requirement in the bill, but still may be authorized by current law. We should make clear that this is a sufficient but not a necessary process, and it does not foreclose anything by implication.

I have one final point that I want to raise that is not in my written testimony. I have submitted a supplemental comment on it, that is actually related to a set of hearings you're holding on FACA at the moment.[1]

This bill would authorize the compensation of participants in the rulemaking committees. That is an important aspect since the overall experience has been that agencies are likely to save significant time and resources by using one of these committees, but, on the other hand, it can require a significant upfront commitment of resources by some organizations that that would be a large chunk out of their budget.

The compensation is, therefore, a legitimate expense of the rulemaking process. Unfortunately, in the Byzantine workings of FACA, currently, if a participant were to receive compensation under this bill, or from any other means, they may be foreclosed by the criminal code from subsequently representing their own employer in the ensuing rulemaking proceeding.

So that if, for example, David Doniger were to participate on a reg neg committee, under the current rules he would not be allowed to file comments for NRDC in response to the notice of proposed rulemaking, or if someone else were to sue it he could not file an amicus brief. That seems to me to be a strange anomaly and I think that ought to be corrected, and I have suggested a sentence in my supplemental testimony to take care of that.

Senator **Levin**. We appreciate that supplemental testimony. We think it is a problem we can fix.

Mr. **Harter**. Thank you. The other problem is that, frankly, those prohibitions are not publicly available. You have to be a Government employee, and somewhere buried in a Government personnel office to know that that law even exists.

Senator **Levin**. It may be a Byzantine law, by the way, but we will be relying on it heavily in about an hour on the floor. Thank you for your testimony and your supplemental testimony, too. They are both welcomed, and of course your testimony will be made a part of the record.

Mr. Brown, you are next.

## TESTIMONY OF KELLY M. BROWN, EXECUTIVE ENGINEER, FUEL ECONOMY, EMISSIONS, AND NOISE CONTROL PROGRAM, FORD MOTOR CO.[2]

Mr. **Brown**. Thank you, Senator Levin. I have a shortened statement in addition to the longer version I submitted to the committee.

On behalf of Ford Motor Company, I appreciate the opportunity to present our views on negotiated rulemaking and offer comments on S. 1504, The Negotiated——

Senator **Levin**. Mr. Brown, I am afraid I am going to have to interrupt you. They need me on the floor now, and we are going to have to take a short recess. I am not sure how long that short recess is going to be, but hopefully not much more than 10 minutes or so. I apologize to all of you but you are all used to this, I know.

[Recess.]

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[1] See p. 199.

[2] See p. 202 for Mr. Brown's prepared statement.

Chairman GLENN. The hearing will be in order. I apologize for the truncated nature of the hearings this morning but that is one of the facts of life around Capitol Hill these days. We have the Defense Authorization Bill on the floor, and Senator Levin and I are both on the Armed Services Committee. We had no way of knowing that the bill was going to be in a crucial stage, and that we were both going to be involved this morning on the floor when we scheduled this hearing some time ago. I appreciate your bearing with us. I do not like to conduct hearings like this, but we are saddled with it today.

Where do we stand? Mr. Brown, you were in the middle of your testimony, I am told, so why don't you go ahead and proceed.

Mr. BROWN. I was in mid-sentence, Mr. Chairman. Maybe I'll start over.

Chairman GLENN. In mid-sentence? All right. Well, maybe you can start over with the whole paragraph at least!

Mr. BROWN. On behalf of Ford Motor Company, I appreciate the opportunity to present our views on negotiated rulemaking and offer comments on S. 1504, The Negotiated Rulemaking Act.

We believe that the negotiated rulemaking process outlined in this bill can be a beneficial supplement to the conventional rulemaking process.

At times, conventional rulemaking can be complicated and even an adversarial process. In certain situations, the direct exchange of views among the affected parties can help facilitate the rulemaking process. This bill would provide guildelines to promote the use of negotiations, where appropriate.

Ford has twice participated in negotiated rulemaking. The first involved EPA rulemaking for nonconformance penalty for heavy-duty truck emissions. The other involved FTC rules for informal dispute settlements.

I represented Ford in the EPA rulemaking and will focus my oral comments on that experience. I should also add that I have represented Ford in numerous rulemakings via the conventional process with EPA and in places like the State of California.

Comments relative to the FTC rulemaking are included in my written statement. The EPA rulemaking was directed at establishing nonconformance penalties, referred to as NCPs, for heavy-duty truck emissions.

EPA was directed by Congress under the Clean Air Act to establish rules for levying nonconformance penalties in instances when a manufacturer of heavy-duty trucks cannot achieve certain Federal emission standards.

Without NCPs, a manufacturer would be prohibited from producing those products that are not available to meet emission standards.

EPA first issued an advance notice of proposed rulemaking for NCPs in accordance with their statutory obligations. However, the comments received in response to the proposal were not favorable.

It was clear to EPA that it would be difficult to issue a rule by way of the conventional rulemaking process. Therefore, EPA decided to pursue negotiated rulemaking in an effort to resolve some of the differences among the affected parties.

Initial meetings were convened in April 1984. Participants included Ford and other heavy-duty truck manufacturers, the Motor Vehicle Manufacturers Association, the Automobile Importers of America, the Natural Resources Defense Council, the California Air Resources Board, a State organization, the Engine Manufacturers Association and EPA.

At the outset, exchanges among participants were somewhat tenuous and guarded, but as the interactive process envolved, there was a more open sharing of ideas, and a sense of commitment.

After numerous meetings, a consensus position was achieved in November of that year.

Two points are worthy of mention. First, there was considerable discussion on the need for compensation allowances and associated eligibility requirements.

This was resolved by agreeing to provide limited travel funds only to parties with legitimate interests that otherwise would not have been able to participate because of financial hardship.

Second, the participants were able to reach consensus on all key issues necessary to issue a final rule. The process successfully led to EPA issuing a final rule in August 1985, based largely on the negotiated recommendations.

Overall, the negotiated rulemaking process probably involved a greater commitment of time and effort in this case as compared to conventional rulemaking.

However, I believe the outcome was worth the extra effort. I also believe the process was effective in this case for the following reasons.

First, the parties affected were involved early in the rulemaking process. Second, participation was limited to a relatively small number of legitimate parties. Third, all of the participants were committed to working toward an equitable rule, and fourth, the process had a specified end date at which time EPA was required to issue a rule.

Ford believes S. 1504 would facilitate the use of negotiated rulemaking as a supplement to the conventional rulemaking process. In addition, the bill appropriately would delegate discretion for use of the process to the administrative agencies.

More specifically, we would like to offer comments on two areas of the bill. The first concerns references as to who should participate in the negotiations.

In some sections, the bill refers to "affected" parties; in other sections, it refers to "significantly affected" parties.

Ford believes the bill should consistently limit participation in each reference to only those parties that would be significantly affected by a proposed rule.

The second concerns the judicial review provisions of the bill. While we believe there should be a commitment on behalf of the participants to the agreements made in the consensus process, the bill would restrict judicial challenges regarding agency decisions made subsequent to the negotiations.

We believe the language should be revised to preserve legitimate judicial rights for all parties.

In summary, Ford supports the concept of negotiated rulemaking as a supplement to the conventional rulemaking process. S. 1504 would provide guidance and facilitate use of the process in situations where negotiations could help in developing a final rule. Thank you.

Chairman GLENN. Thank you, Mr. Brown. Mr. Doniger.

## TESTIMONY OF DAVID DONIGER, SENIOR STAFF ATTORNEY, NATURAL RESOURCES DEFENSE COUNCIL [1]

Mr. DONIGER. Thank you, Senator. I am David Doniger. I am a senior attorney with the National Resources Defense Council. We have 83,000 members and 80 professionals on our staff. We have a full range of environmental issues we work on, and negotiation of all different kinds is a part of our work in these areas, from the settlement of law suits, some of which have been very important in shaping the direction of EPA programs and others, to actual negotiations over consensus legislation, for example, in the area of national energy standards for appliances.

We have been involved in several of the EPA reg negs, and one with the Department of the Interior. We have had some good experiences where there has been success, and some experiences where it has not been successful.

I think that the negotiated rulemaking tool is turning into a niche tool of considerable importance for some class of environmental disputes. We continue to look for opportunities to use it, but in our view, negotiated rulemaking is still in a fragile and experimental stage, and the process of calling and conducting a negotiation is still largely ad hoc.

We do not know why some work and why some do not. We do not know exactly where they can be used and under what circumstances. And there are several drawbacks that come with the advantages of reg neg which need to be considered as well.

One is the danger, which I would like to speak about in a little more depth in a moment, that the process will convert agencies which have missions and mandates into brokers, in a passive way, between interest groups. A second concern is that this process is extremely expensive for the public-interest sector.

For these and other reasons covered in my prepared statement, though we very much support and look forward to participating in future reg negs, it is NRDC's view that it would be best not to legislate a specific set of procedures for negotiated rulemaking at this time. It would be better to let experimentation and learning continue. In our view, the greater use of reg neg would be fostered by a proliferation of successful experiments and satisfied customers better than by the passage of a law establishing a set of procedures.

Now let me, if I may, go into a little detail on a couple of these points.

It does not seem to me that there are firm rules about what is a negotiable issue in a reg neg and what is not. There have been some second order and procedural-type issues which have turned out to be successfully negotiated through the reg neg process. And there are some examples of what would appear to be procedural issues that have eluded compromise.

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[1] See p. 209 for Mr. Doniger's prepared statement.

Most issues of fundamental principle—like how safe is safe, how much cancer risk from radioactive waste disposal sites is acceptible—those kinds of questions should be generally avoided like the plague in a reg neg situation. But there are some examples that have involved health issues, like the wood stove negotiations, where we were able to reach an agreement.

So I do not think we can tell right now when it will work and when it will not. That is why we need to experiment some more.

One very serious concern for the environmental community is that reg neg has a tendency to convert agencies with missions into passive brokers between interest groups. Congress intended the EPA, for example, to be an advocate for protection of health and environment and yet, especially in this Administration, EPA has taken a very passive role. We are concerned that reg neg may accentuate this: that it may further encourage an agency to withdraw from the fray, and leave environmental groups and industry to fight things out in the negotiation and "let us know who wins." In this situation, environmentalists have the most to lose because we rely the most on the agency as a source of data and analysis and we need the agency to be an advocate. We have no substitute for that.

The passive broker effect has happened in some reg negs and not in others. There was a real problem of passivity in the heavy-duty truck negotiations that Kelly Brown and I were both involved in, and yet in the wood stove negotiations, EPA was at some points a real tiger, and was really properly involved in the whole process. I do not know why this happened at some times, and not at others.

Turning to the question of expense, I personally devoted nearly 30 full days to the process of developing the wood stove regulations, and that is easily three to six times what it would have taken to write conventional comments. While we achieved a good outcome in that case, in other cases an equally intense effort has come to nothing. This was the case in EPA's negotiations over the underground injection rules under the Safe Drinking Water Act and RCRA, which broke down. It may be true again in regard to Department of the Interior negotiations over the air pollution from oil development off the California coast, which as of now are stalled.

In the nonprofit environmental community, we simply cannot afford this effort on a regular basis. There has been some effort to raise funds from foundations, but that is not an adequate answer and it has never yet defrayed our full cost of participation.

The bill would authorize agencies to compensate parties in our shoes, but it does not require it. I believe the Government is getting something very valuable in terms of reduced conflict and better rules, and saving resources. For this reason, if the bill does go forward, it should do more than merely repeat the existing authorization for payment of such compensation. It should, I believe, require that in appropriate circumstances public interest organizations and others with the kinds of budgets that cannot support this sort of process—but who are essential to the success of the process—have a means to get compensated for the extra time and effort that is involved in it.

One concern we have about the structure of the bill is that it assigns the final decisionmaking to the head of the agency: when to call a regulatory negotiation, who to invite, when to call it off, and so forth. To be sure, he gets advice from conveners and facilitators and so forth. But the head of the agency calls those shots.

I think one reason that people have been willing to give it a go and experiment in this area is that the process as currently preceived is extemely fragile.

It requires a continuous consent of the parties all the way through and it can't survive significant dissension.

This means that parties have a safety valve if things start to go badly in the reg neg process. They know that they can probably stop the process unilaterally if they need to. Unfortunately, the way the bill is structured, it may encourage some agency officials to press on with things in situations where it's inappropriate, and there is no judicial review provided for the reg neg decisions.

I'm not sure that the answer is here because it doesn't immediately occur to me to whom you assign the powers, if not to the head of the agency. And I'm not sure that adding another layer of judicial review, in the pre-rulemaking state, is the answer here.

But that's one reason why we believe it's better to continue experimenting with the process now, to take advantage of the fragility of the process, and to learn from the experiments.

To conclude, to use an industrial analogy, we are still at the premarket testing stage of making handcrafted prototypes and trying them out in laboratory conditions—maybe test tracks would be a good analogy. It's still premature, I think, to release this product to the market. We think it would be best to continue the experimentation, and we are going to participate in neg negs when the appropriate rules come up for them, we think the best way to sell this process is to continue the proliferation of satisfied customers. That is the better way to move reg neg forward, not to codify a set of procedures at this time.

Thank you for the opportunity to testify.

Chairman GLENN. Thank you, Mr. Doniger.

I like your analogy.

Mr. Zoll.

## TESTIMONY OF DAVID F. ZOLL, VICE PRESIDENT AND GENERAL COUNSEL, CHEMICAL MANUFACTURERS ASSOCIATION [1]

Mr. ZOLL. Thank you very much, Mr. Chairman.

I'm David Zoll, Vice President and General Counsel of the Chemical Manufacturers Association. Thank you for asking us to testify and thank you for taking the time of this Committee to talk about agency rulemaking proceedings, particularly with the important agenda that you have in front of you.

We are a technologically complex and scientifically complex industry, and we're very interested in giving the Government all the tools that we can to help it come out with effective rules.

Our experience has been gleaned from five regulatory negotiations in which we have participated in the health and environmental and safety arena. I'm just going to list seven of the benefits that we think we have found from participating in those negotiations.

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[1] See p. 223 for Mr. Zoll's prepared statement.

First of all, we believe that reg neg can permit dialogue and face-to-face negotiations which improve the technical and scientific foundation of regulation. We think it can permit the agency itself to recognize a basic flaw in its concept of a rule. It can help the different participants evaluate the relative importance of different issues and perhaps identify some middle-ground compromises.

It can enable all the parties and an agency to test some creative ideas without risking litigation. It can minimize the chance of last minute surprises, and it can lessen the chance of litigation. And even where disputes occur, it can narrow the range of disputes that have to be litigated.

And here's a point I would emphasize. It can result in better compliance with rules and fewer resources spent in enforcement. We recognize that there are some disadvantages to regulatory negotiation, particularly the expenses that are involved up front in the process. We think you handle that by trying to be very careful in selecting the candidates for the rulemaking process.

Let me very briefly illustrate what we face all too often as an industry when we go into a formal rulemaking proceeding and then contrast that with what can happen in a negotiated rulemaking.

Let's assume for a moment an agency is going to draft a formal rule that's very technical and very complex. The task of drafting the rule is given to an agency staff, and because of the lack of time or background, they really don't have the ability to come up with a rule that meets the subject they're trying to regulate. So they produce a draft rule, but that rule is approved through the layers of the agency because other people don't have the time or the inclination to second-guess the rule or its details.

So the flawed rule is published in The Federal Register, and the industry and the public interest groups realize they may have to litigate. The public comment period then becomes an effort by all the participants to raise every point of contention they can, throwing into the record all the evidence they can, in hopes that if the agency isn't persuaded by their views, they can go to court and get the court to tell the agency to do the rulemaking over or to declare that the agency was in error in disregarding their evidence.

The agency has to sort through all these mounds of evidence and then come out with a final rule. Someone files a lawsuit, and a bunch of other parties have to jump in, too, because they don't know what the court is going to do with that rule and they have to protect their interests.

Now, when a court finally winds up sustaining a rule, here's an important point, particularly for technologically and scientifically complex industries. The court's decision sustaining a rule is not a determination that the rule is a good one or that it is not flawed. It is simply a legal determination that the agency had the discretion to develop the rule, and that it wasn't arbitrary or capricious in disregarding evidence contrary to the rule. Unfortunately, that means, in the areas in which we have our business, that many flawed rules are nevertheless going to become the law.

Now comes a problem that a couple of other people have talked about, but I think needs to be emphasized.

Industry then has to grapple with compliance with the flawed rule. And the agencies have to enforce a flawed rule, so problems and inefficiencies and controversies are virtually assured.

Now, in negotiated rulemaking, very briefly, there's a time for mutual trust, for candor to provide mutual education. The agency representatives learn information in a context, in a format, which permits them the flexibility to understand that their concept of a rule may be defective.

The different participants learn which problems with the rule are important and why, and to whom. And most importantly, and underscore this, the participants search for solutions to those problems instead of spending time building a record for litigation.

Always the statutory goals of the agency are paramount, but ideas aren't rejected out of hand because a court hasn't considered them. And even if consensus cannot be achieved, the range of disagreements are narrowed, and at least the public and the participants don't have to suffer the cost of litigating needless disputes. And if consensus is achieved, the parties who shaped the rule encounter fewer problems with the compliance and agency enforcement resources are conserved.

I would like to stop at this point and address a couple of comments that have been made previously.

There seems to be a question whether or not this legislation is needed. Clearly, I think the experts have acknowledged that as a matter of a need for statutory authority it is not needed.

But the Congress needs to send a signal to agency staff is that it's okay for a responsible agency to negotiate, that it's not a dilution of their very important stewardship of the public trust.

There have been a number of comments that this bill may prompt people to take too aggressive a stance on reg neg. Some people think the agencies have been too timid. Mr. Doniger believes agencies may simply become brokers, and he thinks we need some more experiments. I agree with him on all of those points he raised. But I think he comes up with the wrong conclusion.

I think what you do is you find a vehicle for encouraging the agencies to participate and then, you train them. Our recommendation is that you find a way to include in this legislation some resources to train people in handling these procedures because you don't learn this in law school.

We also believe something else——

Mr. DONIGER. You don't learn anything in law school. [Laughter.]

Mr. ZOLL. There has been a reference today to bureaucratic resistance to some of these new procedures. And I'd like to look behind that for a moment.

I had the privilege of serving in a Government agency, and I think if you look at what an agency staff member does in order to succeed, you may find part of the kernel of the problem.

If an agency staff member today in any agency wants to be promoted within the Civil Service or use an agency experience to get a job in the private sector, he or she is more likely to try to build a reputation based upon success in using the traditional formal processes of the agency. There is not a lot of incentive to participate in new and evolving activities.

We think that agency management needs to try to redefine professional success within the agency. And our formal testimony suggests that the Administrative Conference be asked to provide some of the management techniques they need to redefine success.

I would offer this observation also. I thought about this coming in this morning. It wouldn't be out of place for the Congress, when it conducts oversight hearings of different agencies, to make some inquiries along with other things that they inquire about an agency, as to what role negotiated rulemaking has it their operations, what they've done to encourage it and, how they manage it, and what they have done to promote it, to train people to engage in it.

As we look across the horizon of regulations that face us, the increasingly complex regulations, it is clear that the way to achieve effective regulations faster and more efficiently across the spectrum of costs from the regulatory initiation through compliance and enforcement, is increased but selective use of regulatory negotiation.

Our final point is that our testimony does emphasize a number of suggestions that would maintain the flexibility of an agency to experiment with new procedures and not to hide bound it so much that it can't adopt particular procedures for a particular rule.

Mr. Chairman, thank you very much again. And I'll stop there and take your questions.

Chairman GLENN. Thank you. Thank you all.

I do have a couple of questions.

Several of you mentioned the hesitancy of agencies to use this process. Are they reluctant because there are not statutory guidelines—because it's too experimental?

Mr. ZOLL. If that's to me, I think I'd go back to the point I made a moment ago, that I think very legitimately some of them wonder whether or not this process is putting them in a position of compromise, or whether or not negotiation is something that they ought to engage in.

I also think it's a question of skills. I also think it's a question of resources.

Chairman GLENN. Mr. Brown and Mr. Doniger have been involved in a reg neg process at the same time.

One of the things that comes to mind is that corporations as large as Ford, GM, Chrysler, and American Motors are industry leaders that speak with considerable authority for the whole auto industry because of their size and economic power.

Is there a different regulatory negotiation process that occurs in that industry's case as opposed to that for a more fragmented industry where there are a thousand mom and pop stores and no one recognized leader, or even three or four leaders that dominate an industry?

It seems to me that it would be far easier to negotiate with an industry where you have a few big timers—big spenders, if you will—who can come together and agree on a position for the industry as a whole, as opposed to a more fragmented industrial group.

Is that true or not?

Mr. **Doniger**. Well, having been in a couple of these, I must say that one of the most interesting things about the truck process was watching the sidelong glances of the different people from the industrial community as they tried to figure out which one of them was going to speak and what they were going to say.

Chairman **Glenn**. These were antitrust sidelong glances?

Mr. **Doniger**. I think they were regulatory sidelong glances.

The only advantage to being poverty stricken in this process is that when you have one representative for an entire community, he does not need to leave the room to hold a caucus. And I found that our community in these negotiations had an easier time of figuring out its position than even a fairly concentrated industry like the auto industry.

I would say that the wood stove makers, who are as close to the mom and pop size as you're going to see in this process, and the truck makers behave pretty much the same way in terms of having to go through a process among themselves to figure out what their position was.

It was interesting to me to actually see them thinking out loud.

Chairman **Glenn**. But another point you brought up was that it is very costly to go through this procedure. Doesn't this make the issue of who gets left out of the negotiations as important as who participates? Everybody—even those not at the table—has to live with the rule that's worked out.

The big industries have staffs and people to do work on a reg neg, but the smaller, more fragmented industries don't have that kind of backing. Mom and pop stores can't drop everything they're doing and run down to Washington to negotiate for a week with other groups.

It seems to me there's a big difference there.

Mr. Brown, do you think there's a difference between the fragmented industries and the large, more organized industries in the use and effectiveness of reg neg?

Mr. **Brown**. Mr. Chairman, there could be, but this rulemaking took place in 1984. And there were more than just the big corporations that you mentioned there. There were other companies that aren't generally recognized as players in the truck industry, but they're very important. Some of them are smaller. A caterpiller tractor company that makes heavy duty diesel engines, Cummings Engine Company, Aveco, and there's some other companies——

Chairman **Glenn**. Would it be your opinion that the reg neg process is equally applicable to fragmented industries as to concentrated industries?

Mr. **Brown**. I believe so, because if you think back to those times, many of us, not by choice, were nonprofit organizations. For example, International Harvester, who at that time was in very dire straits, thought the process was important.

Mr. **Zoll**. Senator, would you permit a commercial?

I think there is a role for trade associations here in providing a brokering opportunity among a group of constituents which also helps in this process.

Mr. **Doniger**. That's what really happened in wood stoves.

Mr. **Harter**. For example, there probably is nothing more fragmented than American agriculture, and several of the negotiations have involved agricultural issues. The Farm Bureau or the Association of Agricultural Employers have served as the trade association in those. And then bring in one or two representatives of each category of members, and wood stoves was selected to make sure that there was a small representative and a representative of one of the larger ones to try and get a broad spectrum, but with the focal point being the Trade Association.

Mr. DONIGER. There is a potential—though I haven't seen it happen yet in my experience—that you could end up with the wrong representative, or a non-representative of a sector.

At NRDC we did some checking to find out if anyody else from the environmental community wanted to participate in the wood stove rule. And there was one group from Oregon which did and did join us in that, because Oregon has a State program, and that group has familiarity with it.

But we could have accidently compromised the interests of other environmental organizations without even knowing it, even though we did our internal checking.

Chairman GLENN. You mentioned EPA's lack of performance in recent years—its lack of willingness to take on the problems that the law authorizes it to.

How much can reg neg be used as an excuse by an agency for not acting? Is that a danger?

Mr. DONIGER. One of the things I'm afraid of is that an agency which is looking for a way to avoid a decision might choose to call for a negotiation and take a long time with it.

That, I think, is what happened in the OSHA benzene negotiations. That issue hung around for 10 years longer than it should have before the standard was finally issued. And OSHA under this Administration didn't want to make the decision, so it tried to bring the unions and the chemical industry and the steel industry together and have them resolve the issue for it.

Actually, in the end, as I understand it, the interest groups did come fairly close to a resolution, and then the agency balked.

But I am worried about the potential for delay, for using this as an instrument of delay.

Mr. ZOLL. But the agency can't compel a negotiation. It can call for it, but if the participants believe that delay is a factor, those concerned may not participate and it will be self-enforcing.

Chairman GLENN. Before my time runs out, let me ask one more question. I have been sitting here thinking that what this bill proposes to do is to address some very tough problems by using a committee process. The dynamics of a reg neg committee, indeed, just the normal dynamics of committee work, are much more dependent on a forceful chairman or a forceful leader than a conventional, regular rule making process in which somebody has the responsibility to get a rule out.

Now, you've had experience in this area. Surely you've worked with a weak chairman and a strong chairman. Is this a valid factor?

Mr. DONIGER. It's extemely valid. In the wood stove negotiations, the person from EPA delegated to represent the Agency is an extremely strong character, and he's an engineer with good credentials in this area and had a good team of people. And he and his team really led everyone through that. And they hammered on me, and they hammered on the industry. And we hammered back, and we came to a consensus.

In the instance that Kelly and I were involved in about the truck engines, our first point of agreement was that the agency wasn't playing a role. And we had to sort of yell at them to get them involved. In the instance that Kelly and I were involved in about the truck engines, our first point of agreement was that the agency wasn't playing a role. And we had to sort of yell at them to get them involved. And in the final analysis, it was a computer jockey from the Office of Management and Budget who figured out the formula that we all managed to agree upon as the basis for these penalties.

That was somewhat of a capricious process but it worked.

Chairman GLENN. Maybe then, you two were the strong personalities in that case which worked out well.

Mr. BROWN. Mr. Chairman, I think leaders will often emerge in a group of people; leaders arose in different areas of expertise, like the Office of Management and Budget, and even within our industry leaders just naturally emerged on the subjects.

Chairman GLENN. Isn't it important who is not at the table, particularly with regard to fragmented industries—the issue I brought up before? For example, what about a groups like consumers who don't have trade associations, is that a concern?

Mr. DONIGER. The Consumer Federation of America represented the consumer viewpoint in the wood stove negotiations. That was easy for them because the regulation makes the cost of wood heating cheaper.

But it is very important to have consumer interest there. The Consumer Federation was the only group which insisted that it could not participate without compensation, and it did receive some compensation.

Our group took the position that, in this one experiment, we were willing to try it one more time without compensation. But I think we've come to the point where we can't do that any more.

Chairman GLENN. I think for most organized industries, it's just a question of when you want to spend the money. Do you want to spend it in rulemaking process or in a lobbying process later? The Washington woods are full of lobbyists, as everybody is aware. We even have some in this hearing room at this particular moment. And I wouldn't stop that process. We get a lot of information from lobbying efforts around here.

But I wouldn't think the cost for major organizations of trying to influence things earlier would be much different than to alter later what's already been decided.

Mr. BROWN. Well, since we managed to get David, who is a lawyer, talking like a product engineer, let me relate it to our product engineering. At Ford we've gone through a similar corporate culture change. We recognize that the culture change, which is involving people, including assembly workers, in the decision process is more expensive; but the benefit derived is in the equality of the end product. And I think that's also evident here. It certainly was in our rulemaking.

Chairman GLENN. Thank you.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

I'm sorry that I missed some of your testimony. I'll try to catch up with it. May I say, Mr. Brown, I'm sorry to have missed you in particular because you travelled from Michigan to testify. And that's not something which a Senator from Michigan is supposed to do. [Laughter.]

But we've got a close ally here from Ohio.

As I understand this panel, if I can summarize it, you are all supportive of reg neg it the right setting, for the right proposed rulemaking.

I think you're all supporters of reg neg being flexible, and of wanting to keep other potential approaches open. So you want that flexibility to be preserved in any framework that we put into law.

I think you are all in agreement on the goals. You've had positive—for the most part—positive experiences with reg neg.

Three of you are more or less supportive of a statutory framework for reg neg, as I gather it; one of you is more or less leery of putting a framework into law.

What I'd like to do is ask a few specific questions individually of you, now that I've tried to fairly summarize where I think you're all coming from.

First, Mr. Harter, let me ask you this question. Under FACA, a negotiated rulemaking committee would be required to have open meetings—not a subcommittee thereof but the full committee.

Mr. HARTER. Right.

Senator LEVIN. Will that inhibit frank discussion?

Mr. HARTER. When I was initially thinking about this process and talking to experts on negotiations, they were absolutely uniform in their opinion that the openness would be a major inhibition and would perhaps even bring its downfall.

For that reason, in my early writings, I urged that these committees be allowed to close meetings so that you could negotiate behind closed doors.

Experience is a wonderful teacher, however. Closing meetings where public policy is being discussed carries its own fairly high price tag of suspicion and worry. Overall, holding the meetings in the open has not proven difficult. By and large, the participants of those committees have been able to raise the issues, discuss them relatively frankly, with really very little inhibition.

There are lots of cautionaries saying, well, let's just throw out this idea, let's fly it by, and all kinds of disclaimers and whatnot, and maybe some details get worked out in telephone calls. But, overall, I remain a fan of opening the meetings because I think it has important secondary benefits.

Senator LEVIN. Mr. Brown, you may have already answered this in response to Senator Glenn's question. I missed it if you did.

When you participated at the emissions negotiation, did you represent Ford only, or did you represent the industry?

Mr. BROWN. I represented Ford Motor Company obviously, and from time to time, at the committee and subcommittee meetings, I also spoke for the industry.

Senatoe LEVIN. Were there others representing other manufacturers in the industry?

Mr. **Brown**. Oh, definitely. Majors and minors.

Mr. **Levin**. Mr. Doniger, let me ask you about your reluctance. I think it is mainly because you don't want to close off some of the flexibility of the regulatory negotiation process and the experimentation. We don't either. I don't think anybody wants that.

We would be concerned if there is any part of S. 1504 which might inhibit flexibility or experimentation which is an important part of reg neg.

Is there anything specifically in S. 1504 that we could amend or change that you see as creating some inflexibility?

Mr. **Doniger**. Well, I mentioned in my testimony the need to deal with the compensation issue. Let me put it this way. If there's a problem in this process, it's that compensation is not available to use. We need to make it possible to fully participate. But that would be something added rather than something taken away from the bill.

I'm more concerned about the mood this legislation would create. As I said in my testimony, what we have is a very fragile experiment going on, and there's a protection for the parties in knowing that they can probably bring the process down if it starts to go badly for them. That gives them a little bit more willingness to take risks and go forward with it and stick with it. And when you get an agreement, that's terrific.

I'm concerned that giving the agency head the authority to make all these calls, albeit with advice, is going to be misinterpreted by some agency heads as a feeling that Congress had told them, go out and make the decisions, not only about the rule, but how to negotiate the rule. And that fear that the agency had is going to have more power, without judicial review, is going to make potential participants more leery of negotiating.

So I'm afraid that you may accidently hinder the development of reg neg by giving it a firmer footing in the statute. Because it won't be as fragile, and people who you're asking to take the risk of being involved in it won't be as protected.

So I don't really know how to solve this problem. That's why I'm recommending that we let the experiment continue.

Senator **Levin**. I'm not sure I understood the middle part of what you said.

Tell me again. The reference to judicial review and the power of the regulatory agency, how was that changed by this framework?

Mr. **Doniger**. It isn't changed. In the informal development of this process, it's obvious that the agency has to want to do everything that's involved in order for it to happen. But it's almost as though the agency and the parties at the initial stages of a convening a reg neg are equals. And the agency is saying, "Well, I'll do it if you will," and we're saying, "We'll do it if you will." And it works if everyone is willing.

The way the bill structures it, it says to the agency head: Go get some advice from conveners and facilitators about what the right subjects are and who the right people are to be there. And then you decide what should be negotiated, who should come, how should it go, when should you call it off, and what to do with the results. That, I think, is going to be a different signal to the agency heads and the agency personnel that you're trying to urge to use this process.

I'm not talking about EPA so much because EPA is used to reg neg already. You must be thinking about HHS and other agencies that aren't doing this yet. And the signal that you would be sending them in this bill is a rather conventional signal about who is in control. And yet reg neg is an unconventional process of sharing control and seeing if you can't by agreement work out something better.

Senator LEVIN. You're not afraid that this would encourage agencies to use reg neg where it's not appropriate?

Senator DONIGER. Yes, I am.

Senator LEVIN. It is the subtleties of once they decided to use it, you think are shifted by setting up a framework for those agencies that need some guide. You think this is not just discretionary guidance to an agency but that somehow or other the agencies would feel that they must follow a certain route rather than that they are hereby authorized to do it? Is that——

Mr. DONIGER. Well, they would get the wrong idea that they are in control of this process. And the essence of a negotiation is that no one is in control of the process, everybody is trying to reach an agreement.

May I add one thing. I am concerned about the potential for an agency whose leadership is adverse to its congressional mission. It doesn't want to do what it's supposed to do.

When facing a tough call where putting out a regulaton would offend an industry, for example, they will say, well, all right, let's delay this tough call. We'll investigate whether to hold a negotiation. That takes 6 months.

Senator LEVIN. They can do that now, right?

Mr. DONIGER. I know. But it's much easier now, without a statute, parties to say no, we're not interested, skip that, get back to the main job of developing your regulation.

This bill is going to change the aura of that potentially. And I'm concerned about the potential that some agencies may have to use this as another excuse.

Please don't get me wrong. We've been involved in these processes. When it's the right rule and the right context, it works and you get good results, and we'll continue to do it.

Senator LEVIN. It's a balancing operation for us. You have a lot of agencies that just won't try reg neg, because they think there are legal problems in trying it. They think there are practical problems in trying it.

Mr. DONIGER. I suggest you call them up here and have an oversight hearing about that.

Senator LEVIN. They're all aware of the potential.

Mr. DONIGER. Yes.

Senator LEVIN. They've looked into it, and they think there has to be a framework, there has to be a resolution of any FACA issue. And they are using the lack of a framework as an excuse not to try something which I think everyone who's tried it, at least in the right regulation, thinks has been useful. Not that it's always useful but that it can be useful.

So we have a number of agencies who are using as an excuse not to do something the absence of a framework, whereas your fear is that the presence of a framework would result in the reduction of the flexibility of reg neg.

What I'd like to do relative to this point with you and the other members of the panel, because I think we're all interested in the flexibility and the voluntariness of the process—that's the beauty of it, the coming together freely to work out something which we all then have an interest in protecting, the final resolution which tries to satisfy the interests—I would invite you and the other members of this panel and, indeed, the other panel and anyone else who is interested to suggest ways to us that we can make it clear in this framework, if we adopt it, that it is not intended to remove what you call the fragile desirability of the current approach.

I don't think we want to do that. We really want to give a little bit of framework to those agencies who perceive the lack of a framework to create hurdles for them and problems for them.

I know you don't want us to proceed down this line, and you may indeed not want to make what we produce any more desirable because you would rather us not produce anything. But if you do feel comfortable in suggesting changes in this framework—and I'm looking at you but I address the other members of the panel as well, although they come to a different conclusion then you—since we all have that same goal in mind, any specific suggestions on how we can avoid that problem, which we would all like to avoid, would be welcome.

Mr. DONIGER. I appreciate that.

May I comment, one comment?

Senator LEVIN. Sure.

Mr. DONIGER. Regarding agencies that are using lack of a framework as an excuse, I suspect that some of them would find some other reason not to do it.

Senator LEVIN. They could.

Mr. DONIGER. So the problem is going to be motivating them, not enabling them.

Senator LEVIN. It could be. They may have to find another excuse. That, I think, also discloses something in the process.

One additional question, Mr. Zoll.

How did the CMA come about to participate in the negotiated rulemakings that were held by the EPA and OSHA? Did CMA call the agency, or did the agency call the CMA, do you remember?

Mr. ZOLL. Boy, I sure don't.

Mr. HARTER. In the first negotiation the agency called the CMA.

Senator LEVIN. Pardon?

Mr. HARTER. In their first participation, the agency called CMA, in OSHA's benzene negotiation.

Mr. ZOLL. Benzene, they did, yes, I remember that. That's right.

Mr. HARTER. Because I did it.

Mr. Zoll. Yes, you did it. Yes, we got the first call.

Senator LEVIN. One other question. Your written statement expresses some concern about confidentiality. How was that issue handled in the reg negs that you participated in?

Mr. Zoll. Confidentiality, as we address it in our testimony, is primarily not confidentiality from public disclosure, but a confidentiality in terms of what things you put in the rulemaking record once it's certified from the negotiating committee.

We want to preserve the candor and the opportunity to float creative or even strange ideas that might be presented in the context of the negotiating committee, and not have them viewed as "a concession" or as something that might be used in a legal forum, such as in the regulatory rulemaking. We wanted to preserve that distinction.

So that was our line of demarcation.

Confidentiality has not been a problem. I believe where it was a concern were some private caucus groups established, but there was full disclosure of the ultimate basis of the negotiations. But there were some opportunities for some work groups to convene in private.

But I don't believe that confidentiality, as Mr. Harter said, has been a probelm for our industry groups.

Senator Levin. Okay. Any of you want to make any other comment before we close?

What we'll do is leave the record open for any additional comments that you have, and your statements will be made part of the record in full, as I think probably was indicated already.

We will have some additional statements for the record from Mr. John Dunlop, Professor of Economics at Harvard and former Secretary of Labor;[1] Mrs. Margaret Seminario, Associate Director, AFL-CIO, and a reg neg mediator; [2] Ms. Gale Bingham, who is Director of the Program on Environmental Dispute Resolution,[3] the Conservation Foundation and a reg neg mediator; Mr. Frank Wilcher, Jr., who is President of the Industrial Safety Equipment Association,[4] and perhaps a number of others.

We are very much indebted to our panelists this morning, and also to your patience with this panel. We had to come and go.

We will stand adjourned.

[Whereupon, at 11:07 a.m., the Committee adjourned, subject to the call of the Chair.]

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[1] See p. 472.

[2] See p. 460.

[3] See p. 466.

[4] See p. 481.

# REGULATORY REFORM: FEDERALISM AND THE REGULATORY FLEXIBILITY ACT

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WEDNESDAY, SEPTEMBER 14, 1988

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Committee met, pursuant to notice, at 10 a.m., in room SD-342, Dirksen Senate Office Building, John Glenn, Chairman, presiding.

Present: Senators Glenn, Levin, and Heinz.

## OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The Committee will be in order.

The balance of power between Federal, State, and local governments determines how well and how fairly this country conducts its business of governance. Today, we will assess this balance as it is reflected in the conduct of our programs on environmental regulation.

Using environmental policy as a case study, this morning we will examine what the present balance of regulatory federalism looks like, review the problems with it, and consider some principles to guide us in our future decisions about how such responsibility should be distributed across the various levels of government.

This is the second in a series of hearings this Committee is holding on regulatory reform. Whether it is through the process by which agencies negotiate rules with affected parties—the topic of our first hearing—or the manner in which agencies coordinate their regulatory agendas—the topic of our next hearing—regulation is one of the most important means by which the Federal Government directs and affects State and local governments. Regulations establishes the balance of power and responsibility that defines our Federal system.

In 1981, President Reagan entered office promising the institution of a "new federalism." He advocated the return of decisionmaking power to State and local governments.

The evidence suggests that some aspects of President Reagan's agenda in this area have been carried out. There has been some transfer of power. But the evidence also points to a transfer of responsibility that has been neither considered nor orderly.

It is true, for example, that since 1979, the States have taken on increased funding responsibility for air, water, and hazardous waste environmental programs. But they have had to do this. Why?

Because their Federal grants have been cut almost in half over this period.

More generally, 9 years ago, the National Science Foundation found that local governments dealt with more than 1,000 Federal and State mandates annually. Today, we will hear witnesses tell us that the burdens on local governments have become even more onerous than that.

The idea of sharing decision-making responsibility for national programs with State and local governments is, in itself, a good one, and I have supported it. However, a policy of "New Federalism" cannot be supported if it is simply a blind for across-the-board cuts and the impostion of increased bureaucratic burdens on our local communities.

Today, we will do what it seems the Reagan administration has not: We will make an assessment of the present distribution of responsibility for implementing Federal regulations. We will examine the Federal procedure—instituted by the Regulatory Flexibility Act of 1980—for relieving the regulatory burden on our local governments. And we will ask—and I hope start to answer—a vital question: How should responsbility for environmental regulatory programs be distributed to ensure both that these programs succeed and that they succeed while benefiting as many as possible and burdening no one unjustly.

Now, that is a big order. But the bottom line is: has deregulation, the changes in the regulatory process, and the evolving relationship between Federal regulators and small governments mean that our Federal regulatory programs get carried out better or less well than they were a decade ago? In short, the bottom line is: does our Federal system of regulation work or does it not work? That is what we are trying to determine today.

Our first panel will discuss the current allocation of responsibility for environmental regulatory programs. Jonathan Lash, Secretary of Natural Resources for the State of Vermont, will present the view of the States.

Jeffrey Schiff, Executive Director of the National Association of Towns and Townships, and Joan Beardmore, Clerk of Warren Township in Ohio, will discuss environmental regulation from a local perspective.

And Jeffrey Leiter will use his experience working with small businesses to throw light on the procedures open to small businesses and local governments overburdened by Federal regulation.

On our second panel, we are honored to have Frank Swain, Chief Counsel for Advocacy of the Small Business Administration, and Richard Morganstern, Director of the Environmental Protection Agency's Office of Policy Analysis. They will explain to us what is being done by Federal agencies to implement the Regulatory Flexibility Act.

Our third panel is led by Elliot Schwartz, Acting Assistant Director for the Natural Resources and Commerce Division of the Congressional Budget Office, CBO. He will present an interim report on a Congressional Budget Office study requested by the Committee earlier this year. The study focuses on the present allocation of responsibility for environmental regulatory programs across levels of government and the economic criteria by which that allocation can be judged.

We would now like to have our first panel come up to the table, please: The Honorable Jonathan Lash, Secretary, Agency of Natural Resources, State of Vermont; Mr. Jeffrey Schiff, Executive Director, National Association of Towns and Townships; Ms. Joan Beardmore, Clerk of the Warren Township, Ohio; and Mr. Jeffrey Leiter, Small Business Legal Representative, from Collier, Shannon, Rill and Scott.

Welcome to our hearing this morning; we look forward to your testimony. Mr. Lash, if you will lead off with any comments you may have. I know that some of you have lengthy statements. We would appreciate your abbreviating them, if they are long. In any event, your entire statements will be included in the Committee record.

We welcome all of you this morning.

## TESTIMONY OF JONATHAN LASH, SECRETARY, AGENCY OF NATURAL RESOURCES, STATE OF VERMONT [1]

Mr. LASH. Thank you, Mr. Chairman.

I am very happy to have the opportunity to appear before the Committee this morning, representing the National Governors' Association. Governor Madeleine Kunin of Vermont chairs the National Governors' Association Panel on Energy and Environment and the relationship between the Environmental Protection Agency and the States is an almost constant focus of that Committee.

I would like, if I may, to begin by placing the issue in context. It is only recently that environmental policy has been set at the Federal level. Historically, environmental issues were treated as private rights and dealt with through the courts, as were other private rights.

It was only in the second half of this century that the Federal Government even began to address large-scale environmental pollution issues, and only in 1970, witnessing the failure of States and local governments to effectively address environmental pollution problems, that the Federal Government began to enact tough mandatory standards.

As everyone who works in the field knows, in doing so, Congress tried an experiment in which the environmental policies are set by the Congress, basic standards are promulgated by the Environmental Protection Agency, but the States are given the opportunity to take delegation of those programs and to implement them at the State level.

At the time that the initial clean air and clean water legislation was passed in the early 1970's, that was a unique form of Federal-State partnership, one that represented an experiment.

Part of the Federal commitment was not only to set minimum standards, but to provide assistance to the States who were, in essence, implementing Federal policy. That partnership has flourished and, despite frequent tensions between Federal administrators and State administrators, has worked well. Virtually all of the programs have been successfully delegated to the States for implementation, and the States have proven to be innovative and generally effective administrators of the programs.

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[1] See p. 242 for Mr. Lash's prepared statement.

It is important to recognize some of the reasons that standards are set at the Federal level. First and most importantly, pollution does not recognize jurisdictional boundaries, and if we ever needed evidence of that, we have had it this summer, as the evidence of global warming, of the ozone hole, and of acid rain seems to become stronger almost every day. States and localities cannot deal with national and international problems by themselves.

Secondly, in the absence of Federal minimum standards, States face the problem of dealing with economic competition. Compliance with environmental requirements is often expensive for the regulated community, and it is simply a fact of life that if compliance is less onerous in one jurisdiction and more onerous in another, there are economic pressures for the industries affected to locate in the jurisdiction where it is cheaper to comply.

Many States have enacted standards more stringent than Federal standards. We feel we can justify that because our public demands it; we feel we can justify it because it is good policy, and we often feel that we can convince industries that the quality of life that we provide is of benefit to their employees that more than offsets the costs of compliance. But, nevertheless, in the absence of Federal standards, States and localities would be under tremendous pressures to fall to the least common denominator in order to attract the industry that we all need to survive.

Thirdly, most of the problems we now deal with are problems associated with national industries and national markets. It is very difficult and very inefficient for each State to deal with those problems separately resulting in sharply different standards for one jurisdiction to another.

Finally, the issues are of such technical complexity that few States have the resources in the absence of Federal support to make the technical decisions that are necessary.

State programs have flourished. One of the reasons the State programs have flourished is the States are in a position to respond to, to listen to, and to understand the industries that are being regulated, the local governments that are affected by national environmental programs. The States are often in a position to innovate more quickly than the Federal Government is. We are often able to develop new programs more quickly and to change them more quickly than the Federal Government can.

One example has been the State response to the problem of leaking underground storage tanks. EPA has just proposed regulations that would require testing and monitoring of the existing tanks. Numerous States already have programs in place.

Vermont, for example, has for 2 years had a comprehensive program in place that requires double-walled, cathodically protected surface monitored tanks, and provides cleanup and tank replacement assistance to tank owners. Our program is an illustration of the fact than when there is a serious problem, States are often able to ace quickly and decisively and meet the needs or their own constituency, while the EPA simply cannot move that quickly.

Despite our capacity to innovate, however, we have a great need for Federal action. As I mentioned, there is the whole question of issues that can only be dealt with on a national or international level, and in that context I have to put in one more plug for congressional action on clean air. It has been a terrible problem for the States and the EPA alike, but particularly for the States, year after year to have to deal with the problems of non-compliance, to have to guess at what future policy will be on air toxics and to have to wait for action on acid rain. Congressional inaction on that subject is probably the single greatest cause of friction between the States and EPA in the environmental field.

In addition, we need action from the national level with respect to the whole agenda of waste reduction and product bans. It is almost impossible for a single jurisdiction, and certainly for a small jurisdiction like Vermont, to have any impact on the national industry selling in the national market in terms of changing its product stream.

A recent report, one I guess that has not been publicly disclosed yet, but which was described in articles in the papers yesterday by a panel of EPA scientists, suggests that EPA's focus should shift radically away from end-of-the-pipe controls and toward the early identification of problems and source reduction, get things out of the waste stream, instead of controlling them at the end.

That is very difficult to do at the State level. It is something that the Federal Government can do effectively, because it can have an impact on national production and national marketing.

Finally, in that area, one particular plug: Congress has already mandated, but the Federal Government has failed to respond to the mandate, that the Federal Government, as the largest single consumer in the country, become a consumer of recycled products. Garbage is a crisis for many States and for many localities. At meetings of State officials, it is the first subject and the most heated subject that is discussed.

Many of us are moving toward very, very strong recycling programs, and the great uncertainty is will there be markets for the materials that we get out of the waste stream. One enormously important step the Federal Government can take in order to assure those markets is to become the customer for recycled products. It means cutting away some of the purchasing red tape. In some cases, it may mean paying a slight premium, but the benefits to the country will be enormous and all of our recycling programs will thrive.

Let me just quickly raise some issues that have created problems in recent years between the EPA and the States. First, I have to commend Administrator Lee Thomas for one set of steps that he has taken. I believe that communications today are better between State programs and the EPA than they have ever been. That is in large part because of the Administrator's commitment to creating mechanisms for effective communication.

There is a committee of top State officials and top EPA officials that meets regularly. The Administrator participates personally, has made it clear to his staff that it is one of his priorities, and it has worked. It has been an important mechanism to improve communication between the States and the EPA. I very much hope that whoever the next Administrator is, he will continue that policy, because it is one that has helped improve our relationship.

In other areas, the news is not so good. Mr. Chairman, in your opening statement you noted the cutbacks that have been made in Federal funding. It is important to recognize that the States are delegates of the Federal Government. We are not implementing purely State policies; we are implementing Federal policies defined by Congress, and part of that cooperation should represent a continuing commitment to funding.

Almost all States are exploring the option of user fees in order to fund portions of their programs. All States are making very substantial financial commitments to their programs, but it simply is not realistic to imagine that the States can provide or will provide full support if the Federal Government withdraws.

In particular, with respect to user fees, many States have found that it is possible to support 20 to 25 percent of their program activities by imposing permit fees and other related fees, but it is difficult to go beyond that. And particularly, because of the variability in levels of economic activity, fee income goes up and down sharply and programs cannot be totally dependent on them.

Finally, many States have found a reluctance on the part of municipal governments to pay such permit fees and user fees and that is a substantial portion of our responsibilities, and State legislatures have not been eager to impose those fees on local governments.

Secondly, the construction grant program, it is the largest single environmental program. The funds are almost entirely passed through to the local levels. The benefits are visible in every community in the country. The rivers that in my State and every other State were suffering the results of uncontrolled discharges have improved measurably as a result of that program.

All parties involved have acknowledged that Federal participation must eventually be phased out. We thought we had an agreement as to the pace and level of phaseout, and the replacement of the existing program with a revolving fund program. Many States have enacted legislation to implement that agreement, and now the administration has failed to fulfill its part of the agreement with full funding of the phaseout process.

For those of us who have already enacted legislation, whose municipal governments have already begun to plan projects and in some cases have sold bonds in reliance on that agreement, that change of heart is a catastrophe and undermines the very, very carefully developed program.

Finally, leadership in Federal standards: Many States are now initiating programs at the local level that simply do not make sense at the local level. One example, I believe 26 States now have developed air toxic programs. They have done so because EPA has failed to implement section 112 of the Clean Air Act, requiring that there be a Federal air toxics program.

A number of States, including eight in the Northeast, have agreed to proceed with their own gasoline volatility standards. That means refiners will have to produce gasoline specifically for the Northeastern market. We are doing that because we are concerned about ozone non-compliance and the health threat that results, and the biggest single step we can take is to impose gasoline volatility standards. We acknowledge that it is terribly inefficient to do that on a regional basis, but we don't see that we have any other choice.

Chairman GLENN. These volatility standards, what do you mean, that you have imposed them locally or that they were imposed by the Federal Government?

Mr. LASH. These are gasoline volatility standards that we are imposing locally in the absence of Federal action, because the single most easily controllable source of the emissions that lead to the photochemical smog that we all face, at least in non-compliance, the single most easily controllable source is fugitive emissions from gasoline filling stations, and by reducing the volatility of gasoline we can have a very substantial impact. We are simply reducing the level of volatility back to where it was about 10 years ago.

Chairman GLENN. There is not a Federal regulation on that, then?

Mr. LASH. There is not.

Chairman GLENN. It is an area that is not regulated.

Mr. LASH. Other areas of the fuel production cycle certainly are regulated, but that one is not and we have addressed it regionally.

Indeed, the northeastern States are even considering adoption of tailpipe standards similar to the California tailpipe standards. Again, it is action we are taking because of the failure of Federal leadership in that area. We acknowledge that it would make more sense to do that nationally.

These could all be taken as examples that the States can in fact undertake these programs on their own and Federal action is not necessary, but it is important to emphasize that our programs will not be as effective and will certainly not be as efficient as would Federal leadership. We are simply doing it because our public is demanding action to protect clean air and clean water.

Lastly, there is the Federal Superfund. The demands of the thousands of sites now on the national priority list and the technical questions involved in cleaning them up, the public relations questions involved in justifying the cleanups have stretched EPA to its limits and beyond. Progress on cleanups has been slow.

In many cases, States are more than willing to act on their own to negotiate settlements with the responsible parties, who now recognize the strength of Federal or State hazardous waste laws, and they are eager to get these liabilities off their books. But the potential for designation of the sites on the national priority list obstruct settlement.

Indeed, even Vermont, which many people think of as populated entirely by cows, has hazardous waste sites and we have recently had two potential settlements with responsible parties halted because the sites were placed on the national priority list. They are quite low on the list and it will be years before EPA has the resources to get them.

It is important that EPA develop the flexibility to allow States to continue in the lead, where the only possibility for interim action is the State-led site.

I am very happy to have had the opportunity, Mr. Chairman, to present some thoughts on this relationship, and I would be happy to answer any questions.

Chairman **Glenn**. Thank you very much. We will save questions until everyone has given their testimony. Then we can have some interplay back and forth.

Mr. Jeffrey Schiff, Executive Director, National Association of Towns and Townships. Mr. Schiff, we look forward to your testimony.

## TESTIMONY OF JEFFREY H. SCHIFF, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS [1]

Mr. **Schiff**. Thank you very much, Mr. Chairman.

I am pleased to be here this morning, representing our organization, which has more than 13,000 local government members nationwide. Most of these governments are very small and very rural, and are representative of the majority of localities in the United States today. There are 39,000 units of local government in America today, and 72 percent of them have populations under 3,000. In fact, fully half of all American localities today have populations under 1,000 people.

Being that small carries with it some important baggage. It means that these communities are led primarily by part-time officials or volunteers. It means that they have little or no staff resources. They have no computers, they do not have excess money to travel to training opportunities in some far-off location, and yet they are relied upon to be very important partners in the Federal-State-local relationship, and that is the crux of the problem we are addressing this morning, Mr. Chairman.

Since most of America's governments are so small and have limited resources, it stands to reason that Federal policy developed for State and local government should be designed with that reality in mind. Instead, we find legislation and regulations which are written with the assumption that essentially there is no difference between a community of 500 people and one of 500,000 people, that their resources are the same. And as a result, responsibility for program implementation and for funding those programs is devolved to units of government, without a realistic assessment of whether there is any chance at all that compliance will be available.

Thus, current policy is creating more problems for us, rather than solving them, and we as an organization are very much interested in solving problems. Local officials are very anxious to address environmental concerns through regulations which will work. However, as currently structured, regulations give us communities which essentially remain unprotected because their governments cannot bear the financial, technological and administrative burdens for accomplishing what is mandated. Little or no creative thinking has gone into alternative technologies, innovative approaches, and other steps which could still guarantee compliance with environmental mandates, but through a process different than a larger community with greater resources might be able to do.

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[1] See p. 255 for Mr. Schiff's prepared statement.

I would like to point out that this situation certainly is not limited to the Environmental Protection Agency, but today that agency has the greatest visibility, because of the responsibilities which have been given to it to regulate some of the most important hazards that face us today. The problem is evident in many other departments of Federal Government and perhaps throughout all government.

Mr. Chairman, NATaT has presented specific information about this situation to the White House last year as part of a project which it designed to strengthen the Regulatory Flexibility Act of 1980. I would ask, with your permission, that a copy of the materials we submitted to the White House be included in the record as a part of our testimony.[1]

Chairman **GLENN**. Without objection, it is so ordered.

Mr. **SCHIFF**. Thank you.

NATaT initiated its regulatory flexibility project to decrease the burdens on small governments, while at the same time assuring that they had the appropriate tools with which to implement Federal policy at the local level: in order to be that partner in the Federal, State, local process, and we have made some progress. We have worked directly with the White House, with OMB, and with EPA, and we feel that there has been some important positive action.

We do believe that the Regulatory Flexibility Act continues to be a very valuable, cost-effective tool which could be used throughout the Federal Government, but essentially is being ignored now, especially with regard to local governments. In fact, we have found, in conversations with Federal agencies, that if indeed they are at all acquainted with Reg Flex, they believe that it applies only to small business, when the law, as initially enacted, applies both to small businesses and to small governments.

We therefore have a series of recommendations which I will share in a few moments, to strengthen and enforce the Reg Flex Act, as the single best way to get environmental and other important national programs implemented effectively, and in a cost-effective manner at the local level.

There are several reasons why we have recommendations for strengthening the enforcement of Reg Flex. First of all, let me be truthful and say that it would be absolutely impossible for an organization such as ours, NATaT, as we call outselves, to go around putting out separate fires in all the Federal agencies that issue regulations or proposed rule-making on an almost daily basis.

We would not be able individually to generate the data, the research, and to present appropriate alternatives for the many regulatory proposals. But even more importantly, through Reg Flex, the Congress has already instructed Federal agencies to do that exact thing on a consistent basis.

Through the Regulatory Flexibility Act, Congress is clearly on the record as supporting flexible rule-making for small governments. In fact, I have told many people that if I had written the law myself, I do not think I could have done a better job, in terms of putting forward what the problems facing small town America are today.

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[1] See p. 270.

The Act establishes as a principle of regulatory issuance that agencies should "endeavor to fit regulatory requirement to the scale of the governmental jurisdiction." Let me just summarize some of those things that already are in Reg Flex that are not being activated by the Federal agencies at this time.

Unless specifically directed otherwise by the Congress, Federal agencies are encouraged, in fact required to look at signficant alternatives to the rules which would minimize economic impact on small entities, to require different or varying compliance and reporting requirements, to allow for the tiering of regulations so that communities with shelter resources would have a different standard of performance, to require simplification of compliance and reporting requirements across the board, and if none of those things were available, to exempt sectors of the local government regulated community from parts or all of the regulations.

In fact, it is interesting from our perspective that the actual publication of the regulatory flexibility analyses, which are required by the Congress, would probably be less important than the process by which that statement would be developed. It would be more important to have a routine situation where the Federal agencies are going through the drill of looking at their proposed rules from the perspective of small governments than actually what they come up with as the bottom line.

The process is what is vital. It requires the rule-maker to think through what they are trying to accomplish from the point of view of a small government: would this approach work; would something be better; could small entities afford to do what the Federal agency is proposing to require; could some other approach or technique or technology work and accomplish the same environmental or other policy goal?

Let us take a couple of examples of what happens when Reg Flex is not followed completely. I would like to point just briefly to the proposed regulations regarding underground storage tank specifically the financial responsibility regulations.

The bottom line is that EPA has taken a congressional mandate which said that it should regulate petroleum marketers and on its own determined that these regulations should apply to everybody who owns a petroleum tank, and if you owned one or more of these tanks you should find somehow $1 million of environmental hazard insurance.

Well, Mr. Chairman, thousands of local governments, more than 28,000 of them with under 3,000 people, store gasoline for their fire engines and police cars and ambulances in underground storage tanks, are providing vital basic services, survival services for their community. Those small communities, under these proposed rules, somehow have to come up with at least a million dollars of liability insurance or close those tanks down.

Many of our small communities, Mr. Chairman, simply could not raise that amount of money if they sold the entire community. Liability insurance for small governments is difficult to get under any circumstances, but these days insurance against environmental hazards is practically non-existent.

Obviously, we are not here this morning to argue the particular issue of the underground storage tank rules, but rather to point out that if a full regulatory flexibility analysis had been undertaken in this case, EPA would most surely have realized what an impossible situation it was creating for America's small communities. The same could be said of many other offices within EPA and surely of other Federal agencies as well.

Just briefly looking at two other recent regulations from EPA; the first one, a proposed rule to remove some of the volatile organic chemicals in drinking water. The cost estimated by EPA, in this case indeed they have done cost estimates, which many times Federal agencies do not perform, indicate that the cost of complying with that particular portion of the proposed rule, would be approximately $3 per household per year in a large system, that is a water system serving more than 50,000 people—$3 per household per year. For a small system defined as 3,300 people or fewer, $41 per household per year, and for a very small system, one serving fewer than 500 persons, $91 per household per year. that range again is quite large, going from $3 per household in the largest communities to $91 per household per year in smaller ones.

In a similar proposal, one to reduce the lead in drinking water, the commensurate cost estimates run from $10 per family for a year in the largest communities to $96 per family per year in a small one, under 3,300 persons, to $367 per year in the smallest communities. Again, that ranges from $10 per family to $367.

These two proposals alone would require our Nation's smallest governments, in fact the people who live in them, to raise their costs of living by $450 per family per year in a small community, and that is only one office within one Federal agency. EPA alone issues proposed rules, of course, almost every day.

I think the point needs to be eemphasized, that I am not here, asking that small governments not be involved with environmental protection, that they should be exempt from environmental rules.

What we are saying is that there most probably are techniques, technologies, different processes, in fact all the things that the Regulatory Flexibility Act already requires, which, if looked at from the small community perspective, would have led the EPA to propose regulations that would not cause such a dramatic impact on small communities compared to their brethren in larger places.

We have, if I may, several major recommendations for improvement in Reg Flex that I would like to share with you this morning. The first, Mr. Chairman, is in section 605(b) of the law, the so-called loophole in the law, which says that if an agency head would determine on his or her own that there would be no substantial impact on a significant number of small entities by a rule which is being proposed, then they, on their own initiative, may cancel the regulatory flexibility process. This is the most popular course of action by Federal agency heads today. This option is exercised almost as a matter of course if the agency even knows that Reg Flex exists. Often, they do not even consider regulatory flexibility in the context of small towns. If they do, then they certify almost as a matter of course that there is "no substantial impact."

It is our belief at the National Association of Towns and Townships, that, given the number of small communities that I mentioned earlier in my testimony, that there is always a significant number of governments being impacted by Federal regulations, and that the impact, given the resource limitations of these communities, almost always has to be substantial.

So, we find that their is no good justification, there should not be certainly a pro forma justification for activating the loophole in section 605(b).

We secondly believe that, although it was very contentious during the development of the law in 1980, that the Congress should revisit the discussion of whether the Reg Flex Act should include a provision for judicial review.

Right now, local governments affected by these regulations have no recourse whatsoever, and our conversations with regulating community indicates that, when confronted with arguments about why they did not do this or that with regard to more flexible regulations, the reaction of the regulators is: "Well, what are you going to do if we do not comply with reg flex?"

We believe that, in the absence of judicial review, or perhaps even in addition to it, the Committee might consider very beneficially the requirement that the Office of Management and Budget be itself required to develop a procedure whereby Federal agencys would be allowed to adopt a certification under section 605(b). That is, that there be a standard government-wide process which would insure regulatory flexibility compliance by establishing criteria which must be met before OMB would clear regulatory proposals, or would allow a Federal agency to adopt the substantial impact loophole.

We think that such an approach would insure that the resources of the Federal Government would be brought to bear on behalf of America's small communities. It would stimulate creative thinking about new, appropriate technologies, about alternative regulatory processes, about innovative techniques to accomplish existing statutory requirements. And that, Mr. Chairman and Members of the Committee, is what we believe the Reg Flex Act was initially meant to do.

A couple of other recommendations that we would like to place before you: We beleive that it would be very beneficial to the Federal agencies, as a matter of course, develop cumulative cost estimates to determine the total regulatory burden of current and proposed regulations which are being placed on local government.

We believe that a recent self-initiated study at EPA, at the direction of Administrator Thomas, called the Sector Study, would be a very interesting and valuable model to be looked at, to see whether these kinds of cost estimates can be developed. We think that Mr. Thomas took a giant step on his own initiative that will help small governments ultimately, and we commend him for that initiative.

We would recommend that if these cost estimates were available, that they be published each year by the agency in their twice-yearly regulatory calendar, and certainly be provided to committees of jurisdiction in the Congress. And Congress itself, Mr. Chairman, should be using those kinds of estimates as it develops proposed legislation, so that it would be able to see up-front what kind of burdens these regulations might be placing on small governments.

Before closing, Mr. Chairman, I would like to mention, because we are very pleased, that a NATaT proposal recently presented to the Administrator of the Environmental Protection Agency makes suggestions for improving small government regulatory policy apart from and in addition to Reg Flex compliance within the EPA, and the main points of that proposal are attached to my statement.

I would hope that the elements of this proposal could serve as a model for other Federal agencies, and that those suggestions would find the same level of acceptance and support that we have received from EPA. In fact, last week, at our annual conference of small town officials, which we call America's Town Meeting, Administrator Thomas addressed our group and agreed to implement virtually all of the provisions of our proposals to EPA.

Mr. Chairman and members of the Committee, we hope that you agree that the situation we are discussing here today merits further investigation by the Congress, that legislation to strengthen the Reg Flex Act would be a very important step to help local governments.

We urge you to make realistic regulations for local government a high priority as you lead this Committee now and into the 101st Congress. We, as an organization, certainly look forward to working with you.

I would be happy to answer any questions you may have at the appropriate time. Thank you very much.

Chairman GLENN. Thank you very much, Mr. Schiff. We will go on with the testimony before we ask questions.

Our next witness is Ms. Joan L. Beardmore, Clerk, Warren Township, Ohio. She is also on the Board of Directors of the Ohio Township Association, and is a member of NATaT, the National Association of Towns and Townships.

Ms. Beardmore, we welcome you this morning and we look forward to your testimony.

## TESTIMONY OF JOAN L. BEARDMORE, CLERK, WARREN TOWNSHIP, WASHINGTON COUNTY, OH [1]

Ms. BEARDMORE. Thank you, Mr. Chairman.

Good morning, Mr. Chairman and members of the Committee. I am serving my ninth year as Clerk of Warren Township, in Washington County, and I speak to you this morning on behalf of the thousands of small governments in the United States. My testimony was provided to you earlier, and just this morning I would like to highlight a few of my concerns about the Federal reg agencies ignoring my concerns about the Federal agencies ignoring the Regulatory Flexibility Act. Two of the Federal mandates that I am concerned with this morning are underground storage tanks and a portion of SARA title III regulations.

At this point, the Federal EPA does require $1 million of insurance coverage for environmental pollution for entities that own or operate one to twelve underground storage tanks. At this point,

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[1] See p. 274 for Ms. Beardmore's prepared statement.

Warren Township does operate five underground storage tanks, and we are currently insured with the Ohio Township Association Risk Management Authority, which is our insurance pooling in the State of Ohio.

In checking with our local agent, we have $50,000 coverage for this protection now. But I checked with him and asked him to see if we could find us the additional coverage and, after several days of checking, he could not offer us that kind of protection. And when I asked him is there another way, he said, well, there is an old statement in the insurance business that any time the fragrance of the premium is greater than the stench of the risk, you can be insured.

Mr. Chairman, the stench of our risk is much greater than our budget can afford. Keeping that in mind, if we cannot come up with that kind of insurance at this time, we would have to remove our five underground storage tanks.

This morning, just for a few minutes, I would like to take you on an imaginary trip around our township. As you are familiar with rural townships in Ohio, we have 3,600 residents, we have 53 miles of township roads. As we go on this trip, you would find that we would have five 1,000-gallon underground storage tanks which house diesel and gasoline for our road and fire equipment.

On any given day, you will find our employees patching and sealing blacktop roads or in the winter months we would be removing the snow. At this point, when they are on their work and they needed fuel, they would just simply take the few miles back to the garage and refuel and go back to work. If our underground storage tanks have to be removed, they would have to make the round-trip to Marietta, which is a 20-mile round-trip trip, not only taking extra traveling time, but we would be buying the gas at a retail price and it would add added costs and time to our road department.

On our imaginary trip, we would also find we have two fire departments in the north and south part of the township, and I would just like for you to imagine that this particular day our fire department had been called to a house fire. The volunteers have responded and, after several hours of work, they are leaving the fire only to receive another call to one of our local plants, which we have several, and they have had a hazardous material fire.

Before we could respond to that fire, we again would have to take all the equipment the 20-mile round-trip to Marietta to refuel, and we would have to say we will be there as soon as we can.

There would also be a problem with that volunteer fire department, because of SARA title III. There is a tremendous amount of paperwork required by each volunteer fire department. The material data sheets that are required, we get those several times a week. The paperwork of keeping the training hours also is becoming much burdensome for the fire department.

The biggest concern that we have with the fire department at this particular point is the amount of training that is required. The bill does require that we have 24 hours of hazardous material training alone, to be a first-responder.

Now, Mr. Chairman, that does not sound like a lot of time, I am sure, but that is not the only training that is required. The State of

Ohio requires numerous amounts of training. There is also business meetings to the running of the fire department. The volunteers do a major part of our equipment repair. They do the upkeep of the building, they paint the walls, they scrub the floors, and so forth. They do many service projects at our local schools. And then, of course, there is always the fund raisers to help supplement the tax budget.

The majority of the fire departments in the State of Ohio operate on very small budgets and the majority of them are volunteers, and these are volunteers giving of their personal time for public service. They want to be informed and to be good volunteers, because it is not only for their protection, but also for that of the community, but they are getting tired of being told we have to do this amount of training, and now you have to add this amount of training. It is taking their personal time from their families.

Our Fire Chief recently visited one of the township meetings and he presented a letter to the Trustees concerning the fire department, and one of his statements was the most devastating threat to the exitence of volunteers is regulation at this point.

The Fire Chief feels that our fire department will be in jeopardy unless changes are made concerning the rules and regulations. He does not plan to serve as Fire Chief after December 31st of this year, and he cites too much time, too many regulations, and too much added responsibility for a volunteer.

As we think over the list of volunteers we have, we have many qualified volunteers who could assume that responsibility, but who else wants to take on the responsibility that has haunted our Fire Chief these last few years?

Mr. Chairman, our firemen want to be prepared for hazardous material emergencies. Warren Township is their home, that is where they live and, of course, they want to protect it and keep it well. They want to be the very best that they can.

I feel that we are not trying to shrug our responsibilities. For the underground storage tanks, currently our road department is already measuring the gasoline and diesel fuel tanks twice a day. They measure them when they come in the morning and after they have used them. We do not have a current metered pump to measure the gallons, so we measure in the morning when they come, they measure it when they leave in the evening, and then the next morning they measure it again to make sure we have not had a leak during the night.

As far as the fire department is concerned, they have a more upgraded pump as so they keep a daily log of every gallon that is taken out of the gasoline tanks that are there.

As far as SARA title III, we have 26 volunteers at this time, and they have already started the training. On the first night of training, 25 of the 26 were there. The one that was not there was working, that was the only reason he was not there. So they are not trying, but they are making a real effort. I personally feel the relief has to come for small governments on the basis of our smallness.

Our underground storage tanks are not the ones causing the big problems. We are not the big players in this situation. We as public officials have a reason to clean up the process, because we are local, grass roots government, and we are here to stay, and we want our township or village or whatever to stay in the condition that it is in.

As far as I can see, the solution to our problems is the Federal agencies being flexible when making the requirements needed, to make the ability to comply to the regulations.

Thank you, Mr. Chairman, for listening to my comments. I thank you for this time.

Chairman **GLENN**. Thank you very much.

The next witness, Mr. Jeffrey Leiter, Small Business Legal Representative, Collier, Shannon, Rill and Scott.

Mr. Leiter?

## TESTIMONY OF JEFFREY L. LEITER, SMALL BUSINESS REPRESENTATIVE, COLLIER, SHANNON, RILL AND SCOTT [1]

Mr. **LEITER**. Thank you, Mr. Chairman.

As you indicated, I appear today on behalf of small businesses and their trade associations. I would like to confine my testimony this morning to examples and experiences I have encountered over the last 8½ years working on Federal environmental regulations for two small business gasoline marketing organizations, the Society of Independent Gasoline Marketers of America (SIGMA) and the National Association of Convenience Stores (NACS).

In the interests of time, I will summarize my testimony. At the outset, it is unnecessary to explain to the Committee the importance of small businesses to this country's economy. While the definition of a small business will vary, a constant is that the financial resources available to small businesses for complying with environmental regulations are more limited than those available to larger companies.

Small businesses are naturally concerned whether the environmental compliance costs can be passed on to their customers in the form of higher prices. Now, please do not misunderstand me: Small businesses are not seeking to avoid their responsibilities for compliance with environmental regulations. Instead, they seek assurances that there actually will be some incremental environmental benefit for each dollar they are required to spend.

In addition to the significant economic impacts on small businesses, the Committee should keep in mind that small businesses have limited staffs to respond to environmental rule-makings and regulations, and that further they must divert substantial time and resources to paperwork and recordkeeping requirements.

I think it is interesting to point out—and several of my colleagues have touched briefly on it—the fact that EPA has recently identified some 85 new and forthcoming regulations that will become effective over the next 5 years that will affect small businesses as well as small governments.

For example, take SIGMA and NACS members for whom LUST (leaking underground storage tanks) rapidly has become SEX (soaring environmental exposures). The principal environmental regulations beyond underground storage tanks that will affect many of these small gasoline marketers include the requirement in some non-attainment areas for ozone in this country to install devices on the gasoline pumps, commonly known as stationary Stage II. In addition, we are looking at possible regulation of the allowable lead content in gasoline, as Mr. Lash noted, fuel volatility, diesel fuel standards, used oil and used solvent management, disposal of hazardous wastes, Class V injection wells under the Safe Drinking Water Act, stormwater runoff permits, and compliance with the community right-to-know provisions, primarily under sections 311 and 312 of title III of the Superfund Amendments and Reauthorization Act of 1986.

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[1] See p. 283 for Mr. Leiter's prepared statement.

I offer this description of environmental regulation—or SEX—to the Committee to highlight several points. First, for some small businesses, such as my gasoline marketer clients, there is significant regulatory activity "on the plate," and it is not going to go away.

Thus, in analyzing the effects of any one particular environmental regulation on small businesses as well as small governments, it is incumbent for EPA to have a clear understanding that its rules do not occur in a regulatory vacuum. The regulatory overlaps need to be considered in developing these rules.

Second, simply learning how to comply with environmental requirements is a time-consuming task for any business, but particularly for small businesses. Moving up the learning curve can be tremendously expensive. All too often, I have seen a significant, initial period of confusion when new regulations are issued by the agency.

Third, the consequential effects of environmental regulations on small businesses often are overlooked. The best example here is that, in order to comply, you need to generate the internal capital to install the necessary equipment and then to maintain it. For many small businesses, going to the bank and obtaining that loan for environmental compliance is difficult, if not impossible.

The banks, because of the legislative-judicial climate, as well as the regulatory climate, have become very leary of making loans for environmental compliance for small businesses, particularly where the property must be used to secure the note.

Recently, we have seen the lending institutions impose very stringent loan conditions, such as substitution of collateral or the acceleration of the note upon the occurrence of an environmental impairment.

Because my time is limited, I do not wish to overdramatize the responsibilities and burdens placed on small businesses by environmental regulations. However, from my brief discussion, I hope it is evident to the Committee that the need for environmental regulations to protect human health and the environment must take into account the abilities, both technical and economic, of small entities to comply with the rules without becoming overburdened and noncompetitive by the responsibilities and the costs.

I should take a brief moment to mention that many small businesses, with their entrepreneurial spirit and talents, do view environmental regulations as possible business opportunities and are taking advantage of that.

My colleagues this morning have done an excellent job of explaining many of the problems that environmental regulations create for State and local governments, particularly municipalities. The range of problems, similar to small businesses, create compliance difficulties, particularly for the smaller communities.

Many municipalities, because of their structured demand for services, have a limited margin, similar to a business, for expanding their financial obligations caused by the requirements of the environmental compliance.

While it is obvious that, on a different tact, small governmental units are regulated entities, under many of these environmental regulations, what is becoming increasingly of concern to many small businesses is that the same governmental units increasingly are being called upon to enforce Federal environmental regulations.

The underground storage tank program and SARA title III are two of the best examples. While logic dictates that the unit of government closest to the problem should be in the best place to enforce, I am not sure this is always the case.

Consistency in application and interpretation of the rules becomes problematic, and, hopefully, we will avoid that with, for example, the corrective action requirements under the underground storage tank program which were promulgated yesterday by the Environmental Protection Agency.

I assume that the EPA and the Small Business Administration witnesses that will follow will describe the requirements and opation of the Regulatory Flexibility Act. While there is always room for improvement, I think I would like to go on record as saying that EPA, as far as the Federal agencies and departments go, has done the best job of incorporating Reg Flex analysis in the rulemaking process. In most cases, the other departments and agencies routinely resist or go out of their way to avoid considering small business impacts, arguing that the rule-makings are exempt from the Reg Flex requirements.

Let me just take a few moments to discuss with the Committee some of the successes small businesses have had under the Reg Flex Act at EPA. Because the final underground storage tank rules were issued only yesterday by EPA—and I should distinguish that the rules that come out yesterday were technical requirements for new and existing tanks, these would go from installation procedures to cleanup requirements.

The financial responsibility rules, that two of my colleagues have discussed, were not released yet. They are due out in another month or 6 weeks.

In any event, Congress, when it issued or directed EPA to implement this tank program back in 1984, told the agency to consider the technical capabilities of small businesses in issuing these rules.

Now, I think EPA's Office of Undedrground Storage Tanks, in developing the technical standards for underground storage tanks, conducted extensive Reg Flex analyses. The agency staff and their contractors conducted substantial outreach to the regulated community, including small businesses, to obtain data. Based upon these analyses, I think EPA did a thorough and thoughtful job in the rules they issued yesterday. While I have my problems with the rules, they did provide substantial flexibility to the regulated community in terms of dealing with their underground storage tanks.

While it is too early to heap praise on the program, particularly when it remains to be seen how many small businesses and small entities may be forced to close or to endure considerable financial problems, I think the lesson that can be learned from the tank program on the technical side, again, is that rules that protect human health and the environment and rules that minimize impacts on small entities are not mutually exclusive.

The success of the tank technical standards, much like the development, will depend on whether small businesses, small governments, EPA, SBA, other tank owners and operators, as well as the environmental community, can work together.

I would just like to mention briefly on the financial responsibility rules, that EPA, at least as far as small businesses are concerned, has done an excellent Reg Flex analysis. I understand what my colleagues have said about the failure of EPA on the financial responsibility side to properly address their concerns.

From what I have been able to gather from talking to EPA staff, I hope my colleagues at the table will be pleasantly surprised when EPA issues its final financial responsibility rules from underground tanks next month.

Another area of success at EPA under Reg Flex has been the title III rules. For example, under the section 311 and 312 reporting requirements for data sheets and routine inventories, EPA is continuing to assess a permanent threshold that would result in less paperwork being generated by small business.

EPA is still interested, for example, in allowing gasoline marketers to submit their tank notifications under the tank program to the title III program in lieu of the routine inventory reports due next March. The agency, I hope, will follow through on that.

I should point out, however, that as part of the title III rules, EPA estimates that typical compliance costs for small business under the community right-to-know program is $10,000 a year.

Where the Reg Flex process and analyses have broken down at EPA, there appears to be several recurring reasons. First, in some instances the Reg Flex analysis has been an afterthought. The appropriate analysis of small business impacts takes place subsequent to the issuance of a notice of proposed rulemaking, and I think that largely the problem that the small government colleagues have had is probably the same thing, that EPA just has not thought about those small entities when going through the process.

In addition, in many instances EPA staff I do not feel have a true appreciation of the pressures, economic and otherwise, on small businesses. This shortsightedness, while I do not believe is intended, largely is the result of a failure to perform outreach to small businesses and their trade associations early on in the regulatory process.

There also is the problem with the consistency of regulatory flexibility analyses at EPA. While the methodology and the quality of data have improved, further progress is necessary. The best example I can offer the Committee here is where the costs of environmental regulations are annualized over a period of years in order to properly assess what the impact of the rules might be.

However, these costs typically are annualized over the expected lifetime of the particular environmental investment, rather than on the basis of a small business' ability to generate and recover the compliance costs. Let's look at the tank program, for example.

It may be appropriate for EPA to annualize the costs of new tank or the new program itself over the lifetime of the new tank and its piping, which is typically 30 years. However, such annualized costs do not reflect that the small business tank owner must go in to a lending institution and obtain financing pegged over a 3- to 5-year payback. State differently, EPA's Reg Flex analysis should consider the abilities of small businesses, as well as small governments, to generate and recover these environmental compliance costs over a period of time that is tied to business realities.

In addition, the Reg Flex analyses have not typically included a consideration of the regulatory overlaps I mentioned at the beginning of my testimony and the other environmental costs facing small business. Again, if a small marketer is required to put in Stage II vapor recovery over a 2-year period and to do a tank upgrade or retrofit leak detection within 5 years, there should be some understanding that the limited scarce economic resources could be conserved and not have to break that concrete twice. You could coordinate these programs.

Again, taking a very narrow view of a particular rule and not considering it in the overall context, particularly when you are looking at these 85 regulations coming down the pike over the next 5 years, conveniently ignores the real world.

As a final matter, EPA needs to remain open-minded about regulatory alternatives and expectations of environmental benefit. One of the regulatory alternatives considered and adopted by EPA in the tank program was a longer phase-in period, and certainly this is something that shuld be included in any environmental Reg Flex analysis.

Based upon my experiences, the successes we as small businesses have enjoyed at EPA have occurred through the joint efforts of EPA's staff, their wilingness to listen and be accessible, EPA's Small Business Ombudsman, SPA's Office of Advocacy, and the Small Business representatives themselves. There has been a coalition building, particularly in the rule development phase, that has been critical I think to EPA obtaining good data and issuing good rules.

Accordingly, I think this informal working group process has enabled EPA to do a better job and should be institutionalized when EPA goes about the development of new environmental regulations.

The problem of small governments in bringing their difficulties to EPA are not different. There are just so many fires that they can fight at a single time, their resources are extremely limited. Typically, they have had bigger fish to fry, and hopefully EPA—and it appears that they are moving in this direction-can more carefully assess the impacts on small governments.

As I mentioned, improving the effectiveness of Reg Flex at EPA can be improved several ways. First, EPA typically employs an internal working group approach in its rule development. EPA should institutionalize, as I mentioned, establishing external work groups, where it is permissible, under the Administrative Procedure Act to get at the small businesses and the other small entities and to get their input very early on in the process. Again, it will make for better rules.

Similarly, the agency should expand its outreach efforts, including education and training, putting the rules in plain English. Small businesses do not have the time to read the Federal Register. It is often too late before they find out what the responsibilities are.

Other actions that could be taken by EPA flow from my earlier testimony, that is, policy initiatives, consider regulatory alternatives such as longer phase-ins, and that these initiatives be automatically considered by the agency. Again, further additional upfront research and analyses should also be mandated, considering the regulatory overlaps, the ability of small businesses to go out to that lending institution and obtain the necessary financing over a reasonable period of time.

Finally, in terms of changes to the Reg Flex Act, I would agree with the other testimony this morning that the Committee might consider amendments to the Act that will make it difficult for departments and agencies to hide behind their RFA certification decisions. The Act should be amended to provide for judicial review, to insure that appropriate Reg Flex analyses are being performed, and that the interests of small businesses and small governments are being considered.

Informed rulemaking are better not only for small entities but for everyone.

Mr. Chairman and members of the Committee, I appreciate this opportunity to present my views. I will be happy to respond to any questions.

Chairman GLENN. Thank you very much.

We have been joined by Senator Levin. Do you have an opening statement, Carl?

Senator LEVIN. I do and I would be happy just to make it a part of the record.

Chairman GLENN. All right, fine.

[The statement of Senator Levin follows:]

## OPENING STATEMENT OF SENATOR LEVIN

Mr. Chairman, I came to the Senate directly from local government. I served for 8 years on the Detroit City Council, for a number of those years I served as its President. I am personally familiar with the difficulties local governments face in responding to the demands put on them by federal agencies. It was bad back then in 1978, it has to be even harder now, because over the course of this Administration more and more regulatory responsibilities have been shifted to local governments. It is wrong for us to continue to do this without addressing the needs and understanding the capacities of these governments to do what we ask of them.

Here, in Washington, we promulgate massive regulatory programs that bear little relationship to the real world. We so easily forget that small, local governments which constitute a majority of the local governments in the nation, are frequently comprised of individuals who are serving their communities on a volunteer or part-time or low paid basis. They aren't experts in wastewater treatment or air pollution or infrastructure repairs. Oftentimes, these local officials have very limited access to technical experts, legal counsel, or even computers. An increase in duties for these small entities can mean great financial difficulty, overburdened personnel, or, as a last resort, noncompliance with the regulation. Yet our federal agencies so often treat them as if they had the capabilities of a large city. That's in part why we passed the Regulatory Flexibility Act—to force federal agencies to take the limitations of small entities like small local govenments into account in issuing regulations.

I am pleased that one focus of this hearing is to look at the extent to which the Regulatory Flexibility Act is being enforced. This Act is an important tool for ensuring agency awareness of the special problems of small entities when formulating regulations. The key is proper and consistent implementation which, unfortunately, has not been the case.

It is my hope that this hearing will shed light on the barriers to the use of this Act, I particularly want to commend the Chairman for calling these hearings, and I thank the witnesses for their participation.

Chairman GLENN. Mr. Lash, you mention in your testimony several areas in which the States would appreciate more Federal input—funding, research, recycling, and international environmental issues, to name a few—and several areas in which there is too much Federal interference. So it appears we are on the horns of a dilemma here. States want help in one area but not interference in another. I appreciate that. There is a balance that we try to hit, sometimes rightly and sometimes wrongly. Hazardous waste sites is one area in which sometimes state and local governments feel there is too much Federal interference, for example.

Is there any general rule that you can help us identify which delineates in which areas you welcome Federal intervention and in which areas state regulation is more appropriate.

As you noted, or someone noted in their testimony, environmental problems are problems that blow and flow across State lines; they are not confined to State borders, as we see them on a map. But at what point does the Federal government become too intrusive? Are there certain areas that you feel we can use as a guideline for what is too much and what is not enough?

Mr. LASH. I think the principle on which the Federal Clean Air Act, the Clean Water Act, RCRA and so forth are based, is the right principle. I do think it is important that there be broad-scale Federal standards that set the basic environmental policies of the Nation, and particularly where we are dealing with national industries. It is essential that there be certain national standards.

We could not have, for example, a cradle-to-grave hazardous waste tracking system, except if that is set up on a national basis. We cannot have effective clean air controls, except on a national basis.

I also think that the concomitent principle that the States can be effective implementers is correct. I think the experience has been that the States are more able to respond to the unique nature of local situations, respond to their own constituencies.

Chairman GLENN. Well, they are, but we are the ones creating the regulations. Again, what is too intrusive and what is not? Maybe this is an impossible question, I do not know. Do any of the rest of you have an answer? What is too intrusive and what is not?

Mr. LASH. I would use as an example the subject that has been much discussed this morning, the underground storage tank rules, because we have some experience with that. In fact, in Vermont, as I expect in many States, it is the single greatest course of human exposure to volatile organic chemicals. Underground tank leads are affecting people's drinking water across our State and across the country. It is a real problem that everybody wants to deal with, so we start with that premise.

Secondly, it is the real problem that can create real liabilities. We have a village just the size of the village that you are from which had an underground tank leak two years ago. They have so far incurred liabilities of $760,000. They are facing lawsuits which will impose millions of dollars of liabilities from a single tank leak which drove people out of their houses.

Chairman GLENN. Is that a case in which we threw you the responsibility but did not give you the wherewithal or the insurance to cover you on what we were requiring? Is that correct?

Mr. LASH. I think that is correct, but I think that it was a question of a problem out-running either the Federal efforts or State efforts to address it. What we found in Vermont, because of precisely the inability of small businesses and local governments to get financial responsibility insurance, is we had to raise our gasoline tax and create a fund to provide that insurance and provide clean-up assistance and loans, because small businesses cannot get the capital.

That is something that is easier to do on a local level, but it will only work if it is done.

Chairman GLENN. That approach has got to have a problem limit, though, because the people at the local level did not seem to be able to do anything about it.

Mr. LASH. It is a problem if people at the local level do not do anything about it, yes.

Chairman GLENN. That is the reason we pass some of these Federal laws. But then we get gripes when we pass a law but do not provide the wherewithal, to enforce it at the local level. And yet the law was passed because there was a local problem to begin with. So we are caught between a rock and a hard place. Any of the rest of you, do you have any general rules we can follow here, or is that an impossible question?

Ms Beardmore, do you have any comment on that?

Ms. BEARDMORE. I cannot think of a general rule that would cover all the issues such as that.

Chairman GLENN. Mr. Schiff, Mr. Leiter, either one of you?

Mr. LEITER. Not a direct response to your question. I really do not think I am in the best position to answer the original question. But on this issue of the tanks and the problems of the local government being the best place, I have got a situation in Senator Heinz's State right now where the appropriate response to a tank leak is to move very quickly. Congress stated that very loudly in the provision that created the LUST trust fund in 1986.

EPA in its final rules said yesterday if you have got a long-term clean-up, where you have to clean up soil or groundwater, you have to submit a plan to the local implementing agency, but if you use sound engineering practices, you can go ahead and start cleaning up and not wait for the plan to be approved, so that we can get on with addressing this situation and mitigate the costs and the environmental damage.

I have had a leak that occurred back in April for a client, a small marketer up there. We submitted a plan to the agency within 30 days. Well, there is a different office within the environmental agency up there that says that you have to have a permit in order to work the soil, because soil venting is the process we are using in the clean-up. We are still waiting for the permit, and here it is 4½ months later.

Chairman GLENN. Well, is this not a real Federal problem? Is there not a general enough problem with underground storage to address it federally, or is it something where we overshot on? Or is it something that if State and local governments had been on the ball—I will be critical of you for a minute—if you had been on the ball, you should have taken action that prevented the requirement for Federal legislation?

Mr. SCHIFF. Our position is that most Federal environmental initiatives and most regulations generally are warranted; there are national problems out there that need to be addressed.

Why we are so concerned about Reg Flex is that we do not believe that the other side of the coin has been reviewed. All we know is that the regulations that are being implemented do not seem to fit in many cases. We do not have experience, however, when there has been consistent, comprehensive exercise of the provisions of Reg Flex to see whether the enormous resources of the Federal Government could be brought to bear to make sure that the regulations are written so that the environmental standard is complied with, but that everybody does not go in lockstep.

If I just might add very briefly, I am somewhat familiar with the late lamented general revenue sharing program. Mr. Chairman, that was a program which was the largest program in the history of the United States. With the stroke of a pen in 1972, 39,000 units of government came under Federal control for the first time, because they never received any Federal money before, never had to interact on a consistent basis with Washington.

Without Reg Flex, because this predated Reg Flex, and because the Office of Revenue Sharing was confronted with a situation whereby the vast majority of the recipient universe would waive their participation in the program, if frustrated by regulations which they never before had to deal with, that agency, on its own, designed its rules so that, through the entire 16-year life of that program, never more than one-half of one percent of all of the recipients ever waived their participation; 200 out of 39,000, and that was because if one reviews the regulations of that program, every time there was a mandate or a requirement—for auditing and public hearings and civil rights and accounting—there was a subsection that said, "and if you receive less than $25,000, do this." It did not change the requirement in the law, it changed the process by which these smaller entities got to the same bottom line.

That is what we believe has not been tried yet, but is called for in Reg Flex.

Chairman GLENN. Fine. We are going 5 minutes on this first round here, and my time is up.

Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you very much. I do have some questions for our witnesses. I just want to make one observation beyond the issue of the Regulatory Flexibility Act, and I would ask unanimous consent that my statement be made part of the record at the appropriate place.

Chairman GLENN. Without objection, it is so ordered.
[The opening statement of Senator Heinz follows:]

### OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, I am glad that the full Committee has taken up the question of federalism, and the Regulatory Flexibility Act. Today we will pay particular attention to the issue of environmental regulation. To a great extent, and often by default, environmental policy is within the realm of State and local governments. The question for us to address is whether that burden has been fairly placed, and whether the goals of environmental protection can be met.

Senator Sasser and I have already held four days of hearings in this area. Last year, during hearings on the fiscal condition of State and local governments, we learned that many communities, having lost general revenue sharing, now must circle the wagons for a fiscal "Custer's last stand." As Federal assistance to State and local governments has declined, the mandates of Federal regulation have not. For many, the picture is one of "fend for yourself federalism."

In April and May of this year, we held hearings on legislation to improve intergovernment cooperation in groundwater management. We learned that accessing the most basic information regarding Federal policy is, as one State administrator put it, "a matter of luck." State and local governments, we found, have little input into regulatory initiatives, have difficulty obtaining Federal guidance, and most cope with competing Federal mandates from different agencies with different jurisdictions.

Our witnesses today have similar testimony to offer. The Regulatory Flexibility Act of 1980, and the administration's federalism order can both help balance Federal, State, and local interests. Today's testimony, however, would indicate that both have little if any force behind them. All too often, they are literally paper tigers.

If today's hearing supports the premise that State and local governments have little protection from Federal mandates, and great responsibility for their enforcement, then we should consider several possible steps.

First, the Committee should move toward a mark-up of S. 2576, legislation which Senator Durenberger and I have offered to create a Department of Environmental Protection. Too often, environmental policy does not receive the Cabinet-level attention which it deserves. Environmental regulation needs to be reviewed by the President, rather than by middle-level managers. Our legislation would ensure that environmental policy and regulatory decisions—whether national, international, or local in scope—are discussed and addressed at the highest level.

Second, we should consider either the establishment of a targeted revenue sharing program, perhaps along the lines of legislation introduced by Senators Sasser, Durenberger, and myself—or, if we cannot revenue-sharing, we should at least be certain we don't force, through unfunded mandates, deficit-sharing. Local governments deserve early warning that mandates are coming, they should be consulted on the impact these mandates will have, and they need a mechanism to respond to proposed regulations.

S. 1992, my groundwater legislation, now on the Senate calendar, has a mechanism which provides local governments with input into groundwater policy development. Perhaps, using that bill as a model, we should expand it to cover environmental policy generally.

Third, we may even want to consider limiting unfunded mandates by statute. Legislation pending before my subcommittee would do just that, and I hope to consider this question further in the future.

I share these ideas with the committee not because I do not want to consider changes to the Regulatory Flexibility Act, but because I think we can do far more to enhance federalism in environmental protection. Indeed, we have a responsibility to do just that. I am looking forward to working with members of the committee to move a federalism agenda either later this year, or perhaps in the next session.

Thank you, Mr. Chairman.

Senator HEINZ. Over the last several years Senator Sasser and I have held hearings on a variety of issues related to some of the problems you brought up. One issue, the lost revenue sharing, has made it particularly obvious that mandates continue to exist or pile up while the revenue with which to implement them has gone down. You all circle your fiscal wagons as a kind of Custer's Last Stand, and I think we should continue to examine, at least insofar as those communities that have been hardest hit by the withdrawal of revenue sharing, approaches to revenue sharing that will be affordable and target those who need the help the most.

We need to find a way to pay for new Federal programs. Even if they cost 25 percent of the old Federal programs—the traditional revenue sharing was $4 billion—we're still proposing about $1 billion in new programs. That is a lot of money. Everett McKinley Dirksen was right.

Second, we need to better address some of the issues you talked about, whether it is the leaking underground storage tanks, or groundwater protection in general.

At our Subcommittee hearings on S. 1992, groundwater legislation, that Senator Sasser introduced, we learned that State and local input into the Federal determination process was, according to one of our witnesses, "a matter of luck." And the rest of our hearings tended to bear that characterization out.

We should try harder to help State and local governments deal with a problem, namely, groundwater protection, that will have profound effects on not only current but countless future generations in years to come.

Third—and this actually goes a bit further than what we have been talking about here—are the issues of, in the environmental area, the visibility and importance of those activities. I happen to believe that environmental problems are not only becoming more serious, but that we are also recognizing the seriousness of those that do not appear to be worsening. This is why a number of use have advocated legislation that would be in the jurisdiction of this Committee, which Senator Glenn so ably chairs, which would elevate EPA to Cabinet status to ensure that the Agency has the proper authority it should.

Those are some of the broader issues I just wanted to bring into the picture. If there is time for anybody to comment on them, please do. If I have any time left, I do want to ask one or two quick questions, one to Mr. Schiff.

Regarding the groundwater legislation, S. 1992, which Senater Sasser and I introduced, what it does is to require the involved Federal agencies to consult with an advisory committee comprised of State and local representatives—such as yourself and other interested parties—on groundwater policy development. Do you feel that a similar mechanism might effectively and profitably be established in other areas so that we would have a more institutionalized structure for State and local governments to provide input into the regulatory process?

Mr. SCHIFF. We certainly do support any efforts to increase the interaction between the regulated community and the regulators, and that kind of approach I think would work very well. We have found, as we travel around the country, that in many cases there is a lack of understanding of the specific problems of smaller communities.

When I bandy about those statistics on the size of local government with which I began my testimony, I get a lot of raised eyebrows. I would like to draw your attention, Senator, to the attachment to my testimony, which is a resume of some of the recent proposals we have made to EPA with regard to how they can go even further than compliance with Reg Flex. Some of those kinds of consultation and other provisions are highlighted in that attachment, and we strongly would support them.

Senator HEINZ. One quick question for Mr. Lash. The Congressional Budget Office already publishes cost estimates on how our legislation might affect State and local governments. I am told by CBO that there is almost no interest in those cost estimates. How can we make it possible for you to utilize this information? That is Congress' intention. You complain about the regulators. We have met the regulators and the guy who tells them to do something is us.

Mr. LASH. I would say, Senator, certainly speaking for one State—I cannot speak for all the States—we do not closely follow the cost estimates put out by CBO, in large part because when we are interested in a piece of legislation, we are looking very specifically at the aspects that will affect us in making our own determinations of how we think it will affect State government and local industries.

I am not sure that is a flaw in the CBO analysis. I think that is in the nature of the legislative process and the very specific focus that we have on those issues.

Senator HEINZ. Thank you. My time is expired.

Mr. SCHIFF. Just a brief response. The CBO estimates, as most other research work which is done in Washington, has a tendency for purposes of administrative ease or cost savings to agglomerate information at a very high level, and that is very dangerous in the local government arena.

For instance. Senator, if data were combined and presented for all communities under 25,000, which is a level of analysis which is used very often in the research and data collection communities in this town, you are then lumping together in one group 95 percent of all the governments that exist in America. You lose all the texture to know what the actual impact would be on different segments of the regulated community, and we think that a major improvement would be to not allow that kind of gross agglomeration.

Chairman GLENN. Thank you.

Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

Let me first commend you, Mr. Chairman, for your holding of these hearings. It is an important initiative. We have an Act here which is intended to provide some protection for small entities. It has not provided adequate protection and as usual, you are right on the ball in your oversight activities in seeing why it is that something which we put into motion, put on the law books has not worked as intended, at least as it relates to the smaller governmental units.

Also, while I am throwing around commendations, Mr. Schiff, your association has been very active in pressing the Committee to have these kind of oversight hearings into this Act, and you and other members of the panel are playing an important role in that oversight process, but particularly your association I want to thank for your various activities in protecting the interests of your members.

My question goes to that loophole that you referred to, as to how that operates. The statute, section 605(b), says that the rule will not apply if there is a certification that the rule does not have or will not have a significant economic impact on a substantial number of small entities. Do you know offhand what percentage of certifications have been forthcoming overall from all agencies?

Mr. SCHIFF. Senator, I do not have a specific number. We have another problem involved with that; many agencies, when we first started getting involved with Reg Flex, did not even know that regulatory flexibility provisions applied to governments. They only applied them to business, so we found not only was there a subset which was activating the loophole, but then there were some that did not even know that they had a loophole to activate. So, I do not have a specific number, but I——

Senator LEVIN. Does the annual report, which is issued, have that figure, do we know?

Mr. SCHIFF. The regulatory report?

Senator LEVIN. Yes.

Mr. SCHIFF. No, not that I know of.

Senator LEVIN. The Advocacy Office has an annual report, right——

Mr. SCHIFF. Yes.

Senator LEVIN [continuing]. On the implementation of this statute? I wonder if any other panelists know to what extent this loophole has been used by the agencies, off-hand, overall, governmentwide? I mean is it used 10 percent of the time or 80 percent of the time?

Mr. SCHIFF. In an informal survey that we did of pending regulations, we found that is the cases where they even took any cognizance of the fact that there was a Reg Flex Act, in the majority of those cases they activated the 605(b) loophole.

Senator LEVIN. Okay. We can find out later. I think it would be useful, Mr. Chairman, I suggest this, if we acquire an annual report to tell us the extent to which this loophole is used, possibly agency-by-agency. I do not knw how much paperwork is involved in that, but they probably have it organized by agency, so I do not think it would be a great burden to ask them to include in the annual report the extent to which this loophole is used. I think we probably could do that perhaps with a letter from you, rather than changing the law.

Second, we have noticed that in a number of the publications of the agencies, not just EPA, that when it comes to assessing the impact on small entities, it says "undetermined." Now, this is not a case where the loophole has been activated, but presumably where they are applying reg flex to themselves. But when they go publish the impact, they say undetermined. Do any of you—I look at you, Mr. Schiff, but anyone can chime in on this—know the origin of that assessment, where in the statute the authority to say "undetermined" is given and that apparently is used to satisfy the requirement of the statute?

Mr. SCHIFF. To my knowledge, there is no authorization to do that. For that reason, we advocate a scenario wherein some agency like OMB had a procedure whereby clearance with Reg Flex was institutionalized governmentwide.

Senator LEVIN. Is that one of your specific suggestion?

Mr. SCHIFF. Yes, it is.

Senator LEVIN. We also see in the loophole provision, 605(b), that where the loophole is used, there is supposed to be a succinct statement explaining the reasons for the certification. Have you done enough analysis of those statements to know whether or not they give the reasons in ways that are understandable, or is it just sort of a conclusion that is given, without an explanation of the reasoning?

Mr. SCHIFF. It is our impression that the emphasis is on the fact that they need to make a succinct statement, and they simply make a statement that there is no substantial impact on a significant number of governments. My personal opinion is that——

Senator LEVIN. So, there is not much of an explanation of the reasons.

Mr. SCHIFF. Right.

Senator LEVIN. It is more of a conclusion, is that——

Mr. SCHIFF. That is our impression, yes.

Senator LEVIN. Your impression. Any material in that area that you put together or have in your files would be useful. Maybe our staff has already done this, but I think it would be useful for us to see whether or not where the loophole is used, whether they give some reasoning for the utilization of it, and not just restate a simple conclusion. We may want to preserve a loophole, as you put it. I think we do have to have some kind of mechanism to utilize it, maybe in the OMB, so we have a uniformity to it, but we ought to have a standard which is used, and it ought to be a standard other than just simply state the conclusion that it is not applicable. The standard ought to be something close to give us an explanation of the reasons, succinct is okay, but not too succinct.

Mr. SCHIFF. There was some additional information which the Chairman has kindly agreed to have included in the record which addresses some of those concerns.

Senator LEVIN. Thank you. My time is up.

Chairman GLENN. Thank you very much.

Let me just say that it is evident that Senator Levin has been a leader on this Committee in his interest in this. His familiarity with details of the Act itself and the law is obvious here and indicates his interest. He has been a real leader; I congratulate him for that.

Just a couple of fast questions here, if I might. I do not know if the answers are going to be as short as we might like at what is beginning to be a late hour, but let me ask a couple of things anyway.

Mr. Leiter, you have explained the different ways that this Act is applied to small businesses, as opposed to local governments. You suggest it has worked better for small businesses. They have been able to take more advantage of the Reg Flex Act than have local governments. Is there any particular reason for that? Do we need to change the law to make it equally applicable to both?

Mr. LEITHER. Senator, perhaps I did not underscore it enough in my testimony, but I think really the success in using Reg Flex on the small business side has largely come from the regulated community, the ability of small business groups to seek out through the——

Chairman GLENN. The small governments also are a regulated community.

Mr. LEITER. I agree that they are also regulated small entities. Just from my experience, for example, in working with EPA on the underground storage tank rules, until only a short time ago, the small governments were not active in the work that was being done on the tank program and they came in late but loud, and I thing EPA is going to listen to them on the financial responsibility aspect.

It is critical to the survival of my gasoline marketer clients, and those groups have just made it their highest priority. We went out and we worked with the Office of Advocacy at SBA and the Small Business Ombudsman at EPA, to make sure the doors were kept open to us at EPA.

Chairman GLENN. Could local governments receive the same access if they took the same aggressive attitude? Do you think they would have the same success that small business has had?

Mr. LEITER. I would think so. Again, there is just so many fish that you can fry, that it is just where it was on their priority list at the time. But, as a result of the lessons that we have learned, the suggestion that I am making is that it becomes a matter of luck, as Senator Heinz talked about, just the ability, the personalities of the staff and other individuals, and that we cannot trust it to luck any longer. What Congress needs to tell EPA, or what EPA needs to do on its own, is to insure that, in the rule development process, not after the rules have been proposed and staff are wedded to a particular alternative or approach, but that the agency institutionalize the outreach to small entities, government and business, that the agency do that up-front analysis early on, get the information in before they come up with the regulatory alternatives.

Chairman GLENN. Okay. Mr. Schiff, briefly, you were jumping up and down to answer this, too, I noticed.

Mr. SCHIFF. Well, I think part of the problem, Senator—and I say this advisedly, because they do a phenomenal job, but the monitorizing agency for Reg Flex is the Small Business Administration, and by definition they would have a greater amount of background and expertise in the problems facing small business and would therefore be more disposed to use that expertise on behalf of them. They are doing a great job on our behalf as well. We have had many meetings with them, but I think that there is an indemic problem in the process.

Also, there have been organizations like ombudsmen set up within agencies for small business, perhaps at the instigation of SBA, through their monitoring rule, and we have not had that.

Chairman GLENN. Okay, Just one more question. I know the hour is getting late, and I will stop after this and submit any additional questions we have for this panel for the record. We would hope you would answer those later on. Other Members may have additional questions also.

But one other issue that bothers me is this whole idea of willy-nilly delegating to local government on so many issues and pushing for local responsibility of these issues. It is true that too much went Federal and we should push it back.

But Ms. Beardmore talks about the problem she is having now. The Fire Chief says he is a volunteer fireman, and says that the Federal Government has put too many regulations on. He is not prepared to go to school on his own time, his own money, and learn how to fight a polytriethylate fire that may occur once every fifty years in his community, if then. But that is a requirement. And so he says, I just cannot do this any more. Small communities are losing this type of volunteer, yet we base a lot of the "new federalism" on volunteerism. That was the big deal several years ago. We were going to have volunteerism and, according to the administration, Americans were willing to accept these responsibilities. Yet the Federal government is making it so that people cannot volunteer without having a lot of onerous responsibilities put on them; so small communities cannot even get a volunteer fire department.

I come from a small town in Ohio, where there is a volunteer fire department. They have won awards, they take great pride in this, but they are volunteers, and they cannot be expected to be full-time pros fulfilling all of these requirements. What is the answer to this? Is there an answer?

Ms. **Beardmore**. When the Fire Chief approached our Board of Trustees meeting, his only suggestion was that we were going to have to have some paid employees. Maybe the first would be just to take care of the paperwork, keep up with the training hours, and he was suggesting that we use three or four departments to go together to fund this particular position.

But then, when it comes to the training, our Fire Chief works for a chemical plant, he is familiar with a lot of these products, he works for Shell Chemical. One of the other firemen works for a fire department supply company, who also is more familiar with these rules and regulations. They feel that they are better informed at their level, in their situation, than the majority of the volunteer firemen. So, the only thing they can see as a possible solution would be going to a paid fire department and, of course, that would mean extra money, it would mean extra taxes, property taxes added to the already burdened taxpayers.

Chairman **Glenn**. Well, are we overdoing some of these regulations? In other words, I suppose 97, 98, 99 percent of the fires that would start in your township. Would be some kid starting a fire in a house or somebody dropping a match or something. A normal house fire would be 90-some percent of their work, I would presume. You have got lots of woods around there. Somebody starts a fire, and your volunteers put out the brush fire before it gets into the forest down there in Southern Ohio. I am familiar with that area, and those sorts of fires would probably cover 98 percent of their work, I would presume.

Ms. **Beardmore**. Exactly.

Chairman **Glenn**. To cover that extra 2 percent, are we putting ridiculous requirements on your force, is that part of the problem?

Ms. **Beardmore**. Yes, I believe. In the City of Marietta, they are the official hazardous material team, but because Warren Township would be the first responder, they are also required, they have to accept the full responsibility. And we have 22 townships in our county, almost every township has their own fire department, because of the size——

Chairman **Glenn**. All volunteer?

Ms. **Beardmore**. All volunteers. Even the City of Belpre, which is smaller than Marietta, they are still a volunteer fire department. So, I am thinking that we can respond to a fire, and as soon as we know it is a hazardous material, call in the Haz Mat Team, do not make the requirements so great that they have to know as much as the Haz Mat Team. Washington County, as long as I can remember, has not had a serious hazardous material fire.

Chairman **Glenn**. And right now, the requirements are the same for the volunteers as they are for Marietta and the communities that have a full-time paid fire department?

Ms. **Beardmore**. The first responder is responsible for the incident.

Chairman **Glenn**. That seems unreasonable. I think we ought to look into that a little bit.

Ms. **Beardmore**. They are willing to do the training, and they can add into their normal training. And as Mr. Knowlton said when I talked to him, he said, as you say, we use it so seldom, that we have all this training.

Chairman **Glenn**. Fine. Thank you very much for this interchange. I will submit some additional questions to you. You have been very responsive, and I look forward to your written responses also.

I may have one, Mr. Lash, that I was going to address to you on how the Nuclear Waste Policy Act has worked out with the States. That is one I have been particularly involved with here. That was my legislation, and we did not have a chance to really get into how it has worked. I would like to get into such things as the siting emergency evacuation plan, transportation, and the Federal-State interaction. We may submit some question to you on that. We appreciate your response.

Mr. **Lash**. I look forward to that.

Chairman **Glenn**. Thank you very much.

The second panel this morning involves assessment of the Regulatory Flexibility Act: Mr. Frank Swain, Chief Counsel for Advocacy, Small Business Administration; Dr. Richard D. Morganstern, Director, Office of Policy Analysis, Environmental Protection Agency.

Gentlemen, thank you for being with us today, and Mr. Swain, if you will proceed with your testimony, we would appreciate it.

## TESTIMONY OF FRANK A. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION [1]

Mr. **Swain**. Thank you very much, Mr. Chairman and Senator Levin. If the Chair permits, I would like to attempt to summarize the relevant points in my——

Chairman **Glenn**. Yes, we would appreciate summaries. The hour is late. I always hate to ask people to come in and summarize everything in sight and submit it for the record, but we would appreciate brevity this morning. Thank you.

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[1] See p. 295 for Mr. Swain's prepared statement.

Mr. **Swain**. Mr. Chairman, I think this Committee is providing a unique perspective on a very important subject. As the Chief Counsel for Advocacy at the SBA for the last 7 years, I have had a firsthand view of the regulatory process within the Federal Government and, in particular, attempting to work with a law that has been frequently mentioned already this morning, the Regulatory Flexibility Act. This law attempts to modify that process, to make the regulatory result more effective for small business and small government entities.

That law requires my office to collect and analyze economic data on the state of small business and to monitor and report to Congress and to the President on the implementation of the Regulatory Flexibility Act.

Senator Levin raised some question just a minute ago which I will attempt to answer.

The Regulatory Flexibility Act, which took effect on January 1, 1981, requires Federal agencies to analyze the impact of their proposed regulations on small entities and, whenever possible, to adopt less burdensome regulatory alternatives which meet the legislative objectives of the underlying substantive statute.

This is a procedural act which, in conjunction with the Administrative Procedure Act, instructs agencies on how to issue regulations affecting small entities. In other words, it is a procedural overlay. When the Congress passes the Clean Water Act, the EPA has to issue rules in keeping with the congressional dictates on the Clean Water Act. The way that they issue those rules ought to be governed in part by the Regulatory Flexibility Act.

In many instances, small governmental jurisdictions are regulated by the Federal Government in the same way as small businesses are. As has already been noted, small businesses, I think, are typically seen by agencies as the primary focus for this law. However, a very current example of small governments being equally regulated is in the area of solid waste disposal, where both governmental entities and business entities will have to follow new and future rules.

Quite often, however, the Federal Government relies on small governmental jurisdictions to be the implementers and the enforcers of the law, and that, of course, is the case in the Superfund community right-to-know amendments, which were discussed previously. Under this law the fire department, the fire marshal and the State civil defense people take on certain additional duties because of what is required by both the law and the EPA regulations.

Therefore, I would suggest that conceptually the issue of how small governments are treated by the regulators is a little bit more complicated than how small business is treated. Small business must merely comply with the law. Small governments, in some cases, not only will have to comply with the regulation, because they are dumping waste, polluting the air or building buildings but also will help enforce the law as a sort of partner with Federal and the State agencies. I think it is a complicated mission that these laws set up for the EPA, in the case that we are focusing on this morning, to try to pick apart that particular relationship.

The premise of the Regulatory Flexibility Act, of course, is that the costs of complying with a particular regulation, whether it is direct costs of staff time or recordkeeping or indirect costs of outside experts or analyses, might be roughly the same in dollar terms for a very large organization and a very small organization.

Certainly, in the case of business, when cost is the same in dollar terms, you have fewer units of sale over which to spread the cost and the pre-sale price becomes a lot higher for regulations. In terms of government, as the anecdote on water rates indicated, the per water customer costs for compliance with those particular water standards is much higher in a small town than in a larger community.

The Act applies to all Federal rules. When the impact of the rule on a substantial number of small entities is significant, the agency must perform a regulatory flexibility analysis.

There was some discussion about when an agency chooses not to perform an analysis. I would say that this is the case in most cases. We probably review something on the order of 1,500 to 2,000 rules a year from the Federal Register.

I would estimate, Senator Levin—and we can go back to our computers and check this—I would estimate that in 80 to 85 percent of those cases, there is a certification that the proposed rule has no significant impact on small business or on small entities, and I would say that in most cases we agree with that.

There are a lot of things that are required to be published in the Federal Register. Such as when landing lights are relocated or other ministerial activities of government, that have no impact on small business.

If I had to summarize where our bones of contention are with other Federal agencies, I would say that about half of our efforts are spent in trying to convince Federal agencies that, often when they say a rule has no impact at all we fundamentally disagree and think a rule does have an impact. When the rule has an impact, it triggers that analysis requirement and it also triggers the requirement that the agency look to alternative ways of regulating.

The other half of our time is spent when an agency does indeed accept that there is an impact, be we believe that they can go further in their analysis of that impact or make the regulatory decision itself flexible.

So, one of the things that the law does allow, of course, is the rule to be considered in two stages. If an agency at the initial proposal stage says that there is no impact, then we can work with them to make sure that they have by the final stage both recognized the impact and proposed alternatives. These alternatives could include the establishment of different compliance standards or reporting requirements—I think that is particularly relevant with the SARA issue.

The issue of SARA is not whether people ought to discharge substances in the environment or have them on the work site. The issue is how much paper you have to fill out and what you have to tell everybody else in the world about what you have got on the site. The use of performance, rather than design, standards are in some cases an exemption from coverage for all or part of the rule.

Now, I am pleased to be on the panel this morning with the Environmental Protection Agency, because we would certainly agree with the previous panel that the EPA has been absolutely tops in the Federal Government in trying to incorporate not only the Regulatory Flexibility Act but also general principles of regulatory analysis onto its procedures.

In fact, I think it is probably the case that some of the principles of the Reg Flex Act were taken from examples of EPA practice from several years ago, and EPA is really, I think, a pioneer agency here in Washington in attempting to calculate what the cost impact of its rules are.

They generally have good processes for addressing small business impacts, and they generally perform economic analysis of proposed rules.

Where we differ with EPA, by and large, is where they have said we think there is an impact and we say we think there is a greater impact and we would suggest that the rules be changed in certain ways.

My statement goes into some specifics. The two major issues have both been mentioned: the UST regulations both technical standards where some of our suggestion have been adopted and financial liability standards. The final rule has not been proposed, but we are hopeful that EPA has taken some of our suggestions to modify the proposed financial responsibility requirements for small entities, both small business and small government.

We have also, I think, had a very productive give-and-take with EPA in the process for writing rules for threshold standards for the Superfund amendments on community-right-to-know. We do not agree with EPA's decisions in all matters, but I think that they have done a tremendous job in trying to be responsive to our concerns which reflect those of the small business community and their trade associations.

I will also say that not represented here this morning are some agencies where, frankly, we are really swimming upstream. We have a real hard time getting the Department of Agriculture's Agriculture Marketing Service to write any rules that say that they have any impact on small business. For example, the USDA regulates the amount of navel oranges that growers in California both large and small can sell concludes that those regulations do not have any particular impact on small business and therefore they are not required to do any analysis.

The Internal Revenue Service certainly writes regulations every week that have a tremendous impact on small business but, because of some administrative technicalities in the way those rules are written and issued, they frequently, if not almost always, avoid doing an analysis of the impact of those rules on small business.

The Federal Communications Commission is an example of an agency that in a couple of instances seeks to certify rules as having no impact, where we think they broadly do have an impact, and we have a hard time in some cases convincing them that they need to do some further analysis.

My testimony is my own personal opinion—this is not a statement that is cleared by every other Administration agency because clearly it would strengthen the Reg Flex Act and be more of a problem for them.

My own personal opinion is that the Reg Flex Act needs a judicial review section. It is a hortatory statute. It allows the Office of Advocacy of the SBA to point a finger at EPA and try to convince them to do something better. We do not have the power of the OMB. We cannot refuse to permit a regulation to be issued. Of course, it is arguable whether OMB has that power. They claim to have it, some others do not agree, but we know we do not have it under the Reguatory Flexibility Act. The result is that if an agency does choose to ignore moral suasion or the mandate to develop a good rule-making record to defend itself in court, we really have no alternative except to issue our annual report, which we are submitting to this Committe as well as to the Judiciary Committee today.

However, if there were a judicial review section that said that failure to perform certain of these analyses, did trigger the right of a court to examine that deficiency in the rulemaking process, I think we would be a little bit better off.

Thank you for the invitation. I would be happy to respond to any questions now or later.

Chairman GLENN. Thank you.

Dr. Morgenstern, go ahead.

## TESTIMONY OF RICHARD D. MORGENSTERN, DIRECTOR, OFFICE OF POLICY ANAYLSIS, ENVIRONMENTAL PROTECTION AGENCY,[1] ACCOMPANIED BY LOUISE JACOBS, CHIEF COUNSEL FOR ADVOCACY

Mr. MORGENSTERN. Thank you, Senator.

I have asked Ms. Louise Jacobs, Chief Counsel for Advocacy at EPA, to join me here, as she plays an important role in the agency in the matters under discussion today.

I appreciate the opportunity to be here today to discuss the way EPA has used Reg Flex, to evaluate and, where possible, reduce the impacts our regulations have on small entities, including, of course, small businesses, small government jurisdictions and small organizations.

The primary mission of EPA is to protect human health and the environment. In working to accomplish that goal, we strive to avoid undue adverse impacts on the economy in general and on small entities in particular, where this does not conflict with the statutory requirements.

Since the Act does not amend or repeal other statutory mandates, however, compliance with the Act must not compromise adherence to the requirements of other statutes. In early 1981, we establish an agency work group to plan for implementation of Reg Flex. Since that time, we have concentrated our most careful review of Reg Flex impacts on small businesses, in the small business area for each of the 200 to 250 rule-makings that are typically under way at the agency and that are subject to the notice and comment provisions of the Administrative Procedure Act.

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[1] See p. 324 for Mr. Morgenstern's prepared statement.

More recently, we have increased our attention to small communities by including them in a study of the impacts of environmental regulations on several sectors of the American economy. The study has been referenced by the previous speakers, and I will discuss it a bit later in my testimony.

The Reg Flex analysis summarizes the economic impact of regulation on small entities and discusses alternatives that might minimize the impact and still accomplish the statutory objectives.

The EPA endeavors to address this by building flexibility into the rule in how small entities can meet the environmental standards without actually weakening them. Impacts on small entities are weighed against risks to health and the enviroment that would result from reducing requirements on these entities.

Consequently, small business in different industries may end up being treated rather differently. For example, under the Clean Water Act, a less stringent standard was set for a particular ferrous sub-category of the metal foundries industry. On the other hand, the effluent guidelines formulated for the electroplating industry did not include any exemptions, even though most of the industry is composed of small plants.

One particular impact analysis which has also been referenece earlier is our proposed rule for lead and copper in drinking water. We group water systems in this analysis into 12 categories, based on the number of people served by each system. We determine the cost of the regulation within each category for each household in the system, as well as categorical and total national costs.

The analysis showed that the cost of this regulation would not be significant, and therefore no special action was warranted. However, we recognized that, due to their inability to benefit from economies of scale, the smallest systems suffer proportionately greater cost impacts. Therefore, we have included numerous provisions in the proposal which would enhance a small system's ability to implement and comply with the regulations. I will list a few of them here for you. They are listed more fully in my testimony.

We are proposing that the monitoring requirements of the rule be phased in over an extra 2 to 3 years for small systems. We are proposing that small systems require fewer samples for compliance. We are proposing that small systems be required to monitor less often than large systems. We are proposing that States may take system size into account when determining appropriate elements of the treatment plant, and so on.

Of course, we are taking broad public comment on these and related issues which affect both large and small systems. Now, EPA has issued many regulations that have less stringent standards for small entities when the agency's environmental and health objectives would not be compromised.

In my testimony, I reference sections 311 and 312 of SARA, I reference work on new source performance standards for new residential wood heaters developed under the Clean Air Act, I reference effluent guidelines for organic chemicals and plastics under the Clean Water Act, I reference various provisions of the safe drinking water regulations, and I reference pesticide registration fees collected under FIFRA.

Quickly, however, I would like to turn to two other initiatives that the agency has undertaken under Reg Flex. The first relates to the Small Business Ombudsman. One of the first actions that EPA took was to set up this Ombudsman. The primary function is to aid the small business community in its efforts to comply with the environmental regulations. Toward this end, the Ombudsman has sought to meld a cooperative working relationship with both the regulated community and key offices throughout the agency.

A second area I touch on briefly is the Small Communities Ombudsman. Presently, EPA is trying to establish a full-time focal point for small communities. This is particularly one of the requests that was made by Mr. Schiff and the NATaT group, and the Administration in a recent speech committed to try to move this proposal forward.

The Ombudsman would serve as a focal point for small community concerns by representing their interests within the agency as well as working directly with small government representatives. This would include the insuring, as we go forward developing regulations, that we look at flexibility for small communities, financially and technically, without weakening the environmental standards in question.

Finally, Mr. Chairman, I would like to discuss briefly the sector study which has been referenced by several of the other speakers. Last fall, Administrator Thomas asked agency staff to conduct an analysis of the costs and risks of environmental controls across different sectors of the economy, primarily concentrating on municipal, small business and agricultural sectors.

The Administrator's request arose from the concern that EPA's regulation review processes only focus on one regulation at a time. Yet, when examined individually, the impact of each regulation may be small, but the cumulative impacts may be much more severe.

The sector study examined costs for 85 recent and pending regulations and for many of them estimated their impacts upon the agriculture, small business and municipal areas. Let me just quickly touch on the conclusions for municipalities and for small businesses.

For municipalities, a significant proportion of communities with under 2,500 persons may be required to raise user fees significantly to finance new capital requirements and expand monitoring, operation and maintenance practices to levels that exceed what most communities have traditionally paid for environmental services.

The largest costs per household to meet the environmental requirements tend to fall ironically on the smallest and the very largest communities in our society. Smaller communities have typically not invested as heavily in some environmental services and technologies, yet they must meet the same technological standards.

For small businesses, a review of nine industries suggests that environmental costs may be high for businesses in three particular industries and in segments of five others. The three which we focused on or in which we found the highest costs were wood preserving, electroplating, and pesticide formulation.

Over all, small businesses with significant environmental problems, such as leaking underground storage tanks or hazardous waste contamination, will face the greatest expenditures in coming years.

The EPA initiated the study in order to provide a critical self-examination of how we as an agency collectively effect certain sectors of the national economy. The information is just one of the factors which can help guide future agency decisions and it will help us in our job of informing Congress and the public about regulatory impact.

Accordingly, we have explored whether our current method of looking at actions one at a time misleads us about cumulative impacts. We also wanted to see if particular cumulative impacts appeared large for any one of the sectors of the economy.

The study is now in the final stages of review and it should be available to the public within the next month.

In conclusion, a major benefit of Reg Flex is that it has significantly increased the agency's awareness of and response to the impacts of its regulations on small entities. In recent years, however, we have seen legislation, such as the Hazardous and Solid Waste Amendments, that limit the exemptions that the agency can grant for small entities.

Although the agency must give primary consideration to reducing risk to health and the environment, we do pay attention to the special burdens small entities bear in adapting to regulatory requirements. Increasingly, education and technical assistance, as well as other efforts to support compliance, have become important ways to achieving the objectives of Reg Flex.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you, Dr. Morgenstern.

Ms. Jacobs, do you have anything to add?

Ms. JACOBS. I think I am here mainly to try to answer questions or to balance the panel. I have the same title as Frank Swain.

Just very briefly, we think at the agency that has some connection with the agency's success, which has been mentioned today, in implementing the Reg Flex Act. We are——

Chairman GLENN. You have received a number of compliments today about how you have moved in some of these areas. I am sure you were glad to hear those in some of the earlier testimony.

Mr. JACOBS. We certainly were. We feel very friendly with our colleagues at this point.

EPA is the only agency in government, outside of the Small Business Administration, with an Office of Advocacy or an advocacy ombudsman function, and I oversee that function. My office works closely with Frank Swain, but we are also able to work within the agency with Dr. Morgenstern and with the program offices in implementing the Act. We can serve on both the staff and policy level, and we work on policy strategies and implementation, as well as regulatory development. We think that that helps to carry out the spirit as well as the letter of the Act.

During the year that I have headed up this office, I have become aware of some real differences that the office has been able to make in helping out small entities and still meeting the goals of environmental protection. We have been a member of all of the work groups and the policy groups, when one existed, for the regs which were listed as success stories in Dr. Morgenstern's main testimony, and we would like to think that we helped create that success, and we have done some other things.

I would just say that we do agree on a less successful front, that we are pretty much in agreement with NATaT, that we need to start doing the same kind of thing for small municipalities and we look forward to doing that.

Chairman GLENN. Good. Thank you very much.

Dr. Morgenstern, you addressed at least in part what my first question was going to be to you and Mr. Swain both. Mr. Schiff recommended that "regular cumulative cost estimates be developed by each agency to determine the total regulatory burden of current and proposed regulations which are being placed on small governments under their jurisdiction." We cannot just toss that responsibility to you, obviously, without considering what is going to be required to carry that task out.

Mr. Swain, you have explained to us some of the deficiencies in the information available about local governments. What do you feel would be required to develop the estimates that Mr. Schiff recommends, is it feasible to do that? And, Dr. Morgenstern, does your agency have the resources to develop the sorts of estimates that we are talking about? You have addressed it in part, at least, in mentioning the study you said was just completed. You gave a couple of examples. But it would seem to me, to be realistic about this, we need something that indicates what the regulatory burden is going to be across the board

Mr. Swain, do you want to comment first, and then Dr. Morgenstern.

Mr. SWAIN. Well, Senator, I would hate to think that any part of the Regulatory Flexibility Act or related statutes constitute a statistician's employment act, but the fact of the matter is——

Chairman GLENN. As soon as we get to judicial review, you are going to add lawyers' employment act to it.

Mr. Swain, I am sure of that. The fact of the matter is that outside of my salaries and expenditures budget, I am given about $2 million a year to maintain a data base on small business. It really is a fairly significant process, largely because we try to keep close tabs on what small businesses are, where they are and how much various actions cost them. Thus, we are able to, in effect, not only ask Mr. Morgenstern's agency to do certain things, but also come to their assistance with certain specific suggestions.

We have no data base on small, local governments, and I am not an expert on where that data is. I do not know where it exists, and frankly I do not know how much it would cost to develop it. But I suspect, as a broad statement, there is more data available on business costs than there is on government costs, so it is a tougher challenge.

Chairman GLENN. Dr. Morgenstern, would you address the issue of data on small governments?

Mr. MORGENSTERN. I think that, frankly, in the course of undertaking the sector study, we became aware of how pitifully inadequate the data is. We struggled with that a great deal, and we have attempted to piece together, I think, a very credible effort, but I think that there is a great deal more information that is needed about small entities, particularly small governments.

Chairman GLENN. What would you need to collect this? Do you need a comparable $2 million like Mr. Swain has to do the job on the small business side of the equation?

Mr. MORGENSTERN. Well I am not ready to speak to particular numbers today, but I think that there would be a great deal more effort. Accompanying that, I must say that probably there would be some additional burden placed upon small entities in gathering that information.

Chairman GLENN. This appears to me to be a really serious need. Would you agree with that? Because if we are going to throw regulations at small government, which I am not objecting to doing necessarily, we really have to know what we are doing, and it seems to me that, unless we have the data base, we are flying blind on this, are we not?

Mr. MORGENSTERN. I think that our data base is quite weak, yes.

Chairman GLENN. Where should such a data base be located? Should it be in your office? Should you be given the wherewithal to create it?

Mr. MORGENSTERN. I think we would need to consider exactly where it should be, but we could certainly give some thought to that.

Chairman GLENN. I would appreciate anything—I will not press it this morning, but any thoughts you might have for the record on this would be appreciated. Because if that is a serious deficiency—and I think earlier testimony this morning shows that it probably is—it is something we should address, in order to make the Reg Flex Act work better for small governments. If we are going to keep throwing regulations at them, then we are going to have to know more about their ability to handle the burden.

Along that same line, the witnesses representing local governments have testified that much of their problem is the burden of a whole range of Federal and State regulations. You have addressed how some of these impact on an individual basis. But are we making an assessment of the aggregate impact of these regulations, the total regulatory burden on small entities? How can we do that?

Mr. MORGENSTERN. Well, the only estimate I am aware of is this initiative that Administrator Thomas has begun in the context of the sector study. I am not aware of any other estimate within the government where this has been attempted.

Mr. SWAIN. I think from time to time, Senator, the Advisory Council on Intergovernmental Affairs, the joint Federal-State-Congressional-Executive Branch, does specific analyses in specific legal fields, some in the environmental and some in the tax field. I am not aware that there is any cumulative total at all, though.

Chairman GLENN. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Swain, let me go through some figures with you and see if I follow this. First of all, it has been alleged that a number of agencies just flat out ignore Reg Flex. Apparently, you have even had to write some letters notifying them of a failure to comply. Is that a large percentage? Do a large percentage of the regulations just completely ignore the requirements of Reg Flex?

Mr. SWAIN. I would not say so, Senator. I would say a large percentage of the regulations are truly irrelevant to Reg Flex, because they have no significant impact on small business. Of those that we think are relevant, I would say that in maybe up to half of the agencies or half of the specific regulations we are concerned with, we must encourage agencies to take that first step to assess impact.

Senator **Levin**. Is the way they avoid that first step by using the loophole, the 605 loophole? Or is the way they ignore it by some other way?

Mr. **Swain**. The former is true. They certify under section 605(b) that the rule that they are promulgating has no significant impact on a substantial number of small entities.

Senator **Levin**. Okay. So, your figure is that 80 percent, in 80 percent of the cases you have that certification. You would disagree with that certification a third of the time, half the time, or whatever?

Mr. **Swain**. Yes, we write about, on the record 60 to 70 letters per year to agencies. I would be happy to go back and count for you how many of those letters we ask——

Senator **Levin**. I do not want a count so much, as I want a hunch. Give me your estimate. If 80 percent of the time when we get a rule, there is certification, which amounts to a waiver or a loophole, that it does not apply.

Mr. **Swain**. That is right.

Senator **Levin**. You would disagree with a quarter, a half, three-quarters of those certifications?

Mr. **Swain**. I would disagree with, by seat of the pants, a quarter of those certifications.

Senator **Levin**. Okay. So, you would think perhaps in 60 percent of the cases there should be a certification——

Mr. **Swain**. That is right.

Senator **Levin** [continuing]. But it is used in 80 percent of the cases?

Mr. **Swain**. That is right.

Senator **Levin**. Okay. Now, let us get to the next question. I notice that at least one agency, in fact EPA, and I will ask them later, uses the word "undetermined" in their publication. What is the basis of that? Where does that come from in the statute?

Mr. **Swain**. Well, the statute requires two types of publications. One, it requires an agenda of on-going and future regulatory requirements that may have an impact on small business, and my experience is that the word "undetermined" most frequently comes up there. We do not quibble with that. We assume that they are in the process of gearing up, and when they get going, then they will determine impact.

There are certainly instances of rules that are freshly promulgated, where they say that impact is undetermined, although our experience is that most frequently they say there is an impact and it is thus and so, or they use a certain indication that there is no impact at all.

Senator **Levin**. All right. Now, going back to that 80 percent, they are supposed to file a succinct statement explaining the reasons for the certification in 80 percent, and give me a hunch, in what percentage of the cases is there a statement explaining the reasons?

Mr. SWAIN. I would be reluctant to give you a percentage. We comment regularly where we feel that the statement is inadequate. I would say that almost every time there is a statement—and in some cases we have to use a common sense test reading what they propose to do—does it make sense that there is no impact. And where we think that is not logical or where we have been alerted by a trade group that some agency is trying to write a quick regulation without proper analysis, then we write a letter and question that.

Senator LEVIN. All right. So, if you agree with a conclusion, even though there is not a statement explaining the reasons for the certification, you do not quibble with that?

Mr. SWAIN. By and large, that is right. That is right.

Senator LEVIN. But is it common in that 25 percent of the cases where you disagree with the certification, that there is an absence of an explanatory statement, where there is an inadequate statement explaining it, or do you just disagree with the conclusion? Do you see what I am trying to get to?

Mr. SWAIN. I see what you are trying to get to. If I could paraphrase, your question is implying do they use the succinct statement as an out or not. I guess my opinion would be that if an agency is disinclined to do an analysis, they will either certify that there is no impact and give us a succinct statement or some times they will not, but the legal and substantive effect is about the same. They just say they are not going to do it.

Senator LEVIN. All right. There has been a suggestion that we give OMB a role in that process.

Mr. SWAIN. Yes, we heard that.

Senator LEVIN. You know about that?

Mr. SWAIN. Yes.

Senator LEVIN. What is your reaction to that suggestion?

Mr. SWAIN. Well, I think that——

Senator LEVIN. It could give a more uniform application to it and put some teeth in it. You do not have any teeth, as you said, it is hortatory. I gather you rarely if ever ask OMB to hold up approving a regulation because it has not adequately complied with the Reg Flex, is that true?

Mr. SWAIN. No, that was going to be my response. We frequently work with OMB.

Senator LEVIN. Have you ever asked them to hold up approval of a regulation?

Mr. SWAIN. Yes, we have and in many cases with success. I think that over the years I have developed an increasingly effective relationship with the OMB. Certainly, the OMB could do a little bit more to systematically take a look at the reg flex issues. They have got the same sort of problem that we have, reviewing thousands of regulations.

Senator LEVIN. Do you agree with NATaT's recommendation that they have a more formal role in this process?

Mr. SWAIN. I would agree that they have a larger role, but have not formulated the specifics. I would be happy to review it and give you my opinion.

Senator LEVIN. It would be helpful if you would give us that for the record.

My time is up. Thank you, Mr. Chairman.

Chairman GLENN. Go ahead.

Senator LEVIN. I just have a couple more questions.

Were you at the meeting NATaT had with OMB, by any chance?

Mr. SWAIN. I was at one or two meetings that they had with OMB.

Senator LEVIN. On the Reg Flex issue.

Mr. SWAIN. Yes, indeed.

Senator LEVIN. I did not have time to ask their representative this morning about OMB's reaction. What was OMB's reaction to the NATAT suggestion that there be a more formal OMB role in this process?

Mr. SWAIN. I am trying to recall, Senator. It is about a year ago and Ms. Gramm, who was then OIRA Administrator, and I were at the meeting, along with several officials from the White House Intergovermental Affairs Office. I think it was primarily to review the government's total role in dealing with the problems of small communities, and that included both OMB's and our role.

I think that OMB indicated that they were interested in doing what needed to be done. I think the people at OMB are good people at analyzing regulations, and they are going to try to do the best they can. I cannot remember that the meeting got to the point of specifics, though.

Senator LEVIN. Would you, in your next year's report—this is something that we chatted about earlier today, Mr. Chairman, and maybe we can just ask directly right now and save the letter. Does it make sense in the annual report for you to give us an agency-by-agency breakdown of the use of this loophole, particularly if you could give us a breakdown of where you disagree with the agency use of the loophole, to identify what agencies you think the loophole, for that annual report?

Mr. SWAIN. Yes, we certainly will. In fact, we will go back and try to supplement this year's report with some additional information on those lines for the Committee.

Senator LEVIN. I think that would be very helpful. My last question is the judicial review issue. When you stated your support of judicial review this morning, you used some words which may or may not have been words of art. You said that you would urge judicial review where there is a failure. It sounded like a total failure to comply. Did you mean it that way, or where the appellant believes there is inadequate——

Mr. SWAIN. Well, it was maybe less precise terms than I intended. I would urge judicial review. If we could start with the statute, the statute right now does not address failure but states that the adequacy or the inadequacy or the compliance by an agency to the Regulatory Flexibility Act shall not, in and of itself, create a cause of action for judicial review, but the adequacy of that compliance shall be relevant in an overall rule-making review.

In other words, when one challenges an agency because its actions are arbitrary and capricious, one indicia of capriciousness might be the failure to do a Regulatory Flexibility Act analysis. What frankly happened, Senator, is that Congress tried to have it both ways. The Congress wanted——

Senator LEVIN. That does not sound like us.

Chairman GLENN. Speak for yourself, Senator. [Laughter.]

Senator LEVIN. Oh, you are talking about the House of Representatives.

Mr. SWAIN. My memory fails me as to where that provision originated, Senator, but I can say that it was not in this Committee. So they wanted to sort of give the flavor of judicial review, but not really very much and——

Senator LEVIN. I want to get to your position. Are you saying that if the allege inadequate administration of the law, that that should be the subject of judicial review, or only the total failure.

Mr. SWAIN. No, I would phrase it in terms of where somebody challenges the adequacy of the compliance. In other words, that might be either a certification or a very superficial analysis, where the analysis ought to be greater.

Senator LEVIN. It is very broad judicial review clause that you are recommending, and I just wanted to make sure I got it. It is not just the total failure, but it is the adequacy.

Mr. SWAIN. Senator, I am very sensitive to the importance or writing a rule with some sort of predictable scale. I am not intending to advocate a very broad standard, but I would advocate something a little bit broader than outright failure of any compliance, and I would be happy to work with anybody to work out a proper approach to that.

Senator LEVIN. Thank you.

Thank you, Mr. Chairman.

Chairman GLENN. I ought to turn all this over to my learned lawyer friend, Senator Levin here, but let me ask a question in this area anyway.

It would seem to me that there is a difficulty with asking for judicial review and at the same time acknowledging that we have a great lack of information available on local governments. I am not sure how a system of judicial review works if we are judging Reg Flex analyses which, by your own admission, would be extremely difficult to carry out.

That is the reason I made my remark before about this being a lawyers' full employment act. If we added judicial review, judges and the courts would be adjudicating all sorts of things or lawyers litigating all sorts of things on which we have very little data—until that is, we develop a better body of facts on what the local governments' capabilities and situations are.

Are there any other ways that you might suggest in which we could augment this information on local governments which would make strict compliance with the Regulatory Flexobility Act more realistic, short of the judicial approach?

Mr. SWAIN. I am not suggesting, Senator, that the judicial approach is the only approach, as has been stated by Mr. Morgenstern and all other witnesses. The law works pretty well now, and I think it could be improved in some ways. Certainly short of changing the statute, one of the ways would be development of more information about how rules affect small towns. That seems to me to be developed in two ways.

One is the way Mr. Morgenstern has already stated, that EPA on its own has done sectral analysis of, among other sectors, the impact of rules on local government. The other way is to address the complaints that bubble up from the trade groups, such as when a trade group comes in and says if you regulate landfills in such a way as you are proposing, it will cost us "X" amount of money. Frankly, good rule-making results from a combination of both of those ways of developing information.

Chairman GLENN. Dr. Morgenstern, do you look forward to having judicial review enacted?

Mr. MORGENSTERN. Mr. Chairman, the EPA does not support a judicial review. We believe this would cause unnecessary confusion and compromise our resources. The statutes under which EPA regulates already explicitly deal with how costs should be considered and these determinations are already subject to judicial review. Requiring any further analysis would be the redundant and cause the agency loss of time or would potentially conflict with requirements of other statutes.

Chairman GLENN. Thank you, gentlemen. We may wish to submit more questions for the record from members who are not here this morning. We had a slight disagreement in that last particular area, and we will end this panel on that note.

Thank you very much. We look forward to getting an early reply to any questions we submit to you.

Mr. SWAIN. Thank you, Mr. Chairman.

Mr. MORGENSTERN. Thank you.

Chairman GLENN. Our last set of witnesses this morning is led by Elliot Schwartz, Acting Assistant Director for the Natural Resources and Commerce Division, Congressional Budget Office.

Mr. Schwartz, we appreciate your patience in bearing with us this morning. It has been a rather long hearing, and because of other commitments we had to get started late, at 10 o'clock, so we appreciate your bearing with us.

If you would introduce your cohorts with you, we would appreciate it.

## TESTIMONY OF ELLIOT SCHWARTZ, ACTING ASSISTANT DIRECTOR FOR NATURAL RESOURCES AND COMMERCE DIVISION, CONGRESSIONAL BUDGET OFFICE,[1] ACCOMPANIED BY ROGER DOWER, CHIEF, ENERGY AND ENVIRONMENT GROUP, AND FRANCES SUSSMAN, STAFF MEMBER

Mr. SCHWARTZ. Thank you, Mr. Chairman.

I would like to introduce my colleagues. On my left is Roger Dower, Chief of our Energy and Environment Group, and on my right is Dr. Frances Sussman, author of the staff working paper that we are releasing today. With your permission, I would like to have that paper included in the record.[2]

Chairman GLENN. The paper will be included in the record in its entirety.

Mr. SCHWARTZ. Thank you, Mr. Chairman.

I am pleased to appear before this Committee to report on work in progress by the Congressional Budget Office on environmental federalism. Programs to protect the environment are increasingly shared by Federal, State and local governments.

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[1] See p. 350 for Mr. Schwartz' prepared statement.

[2] See p. 503.

At every governmental level, constraints exist on the resources that can be devoted to both existing and emerging problems. My testimony today highlights some of the trends in environmental federalism and reviews some specific criteria that may help guide the Congress in making decisions concerning the role of governments in environmental protection.

My remarks, as I said, summarize the staff working paper prepared at the request of the Committee.

As others have testified, the relationship between Federal, State and local governments in the field of environmental protection has changed profoundly over the last 30 years.

If I can turn to the topic of program responsibility, most States now run their own air program under the Clean Air Act, and 39 States run permit programs as required by the Clean Water Act. More than 40 States administer all or part of hazardous waste programs under the Resource Conservation and Recovery Act. The role of the Federal Government has shifted to maintaining a strong role in enforcement, to overseeing and approving State plans, and to providing technical guidance and funds for research.

In the newer environmental programs, States are responsible for initiating many of the regulatory actions for control of toxic pollutants in the air, both outside and inside homes, for protecting groundwater quality and quantity, and for limiting nonpoint-source pollution of surface waters.

This evolution of program responsibility is reflected in the funding for environmental programs. While total environmental programs budgets for Federal and State Governments combined have increased in recent years, the mix of Federal and State funds has changed.

Compared to 10 years ago, EPA's operating budget for the major air, water, and hazardous and solid waste programs has declined in real terms that is calculated in constant 1987 dollars from a peak of $1.1 billion to around $800 million. Federal grants to States have also decreased by almost half, from almost $500 million in 1979 to around $250 million in 1987.

Meanwhile, estimated State expenditures in these areas, excluding money from Federal grants, rose from around $200 million in 1982 to over $400 million in 1986. Thus, States are funding a growing portion of the Nation's environmental programs. In 1982, EPA program grants to States covered approximately half of total State expenditures on air and water quality and three-quarters of State hazardous and solid waste management costs. By 1986, the Federal portion had dropped slightly for air quality and had declined to one-third for water quality programs and to 40 percent for waste management.

These changes in program and funding responsibility have not come without costs. As we have heard this morning, many States and municipalities complain that they are overburdened by their new responsibilites and are or will be unable to raise the necessary revenues to continue to manage and enforce existing programs or develop new ones.

The roles for Federal, State and local governments in environmental protection have not yet been fully defined. Governmental roles in the more mature air and water programs continue to evolve. Newer environmental programs present an even cleaner slate for defining governmental roles. The ultimate assignment of responsibility for environmental protection among different levels of government will determine, in large part, the types of programs that are developed, the effectiveness of these programs, and the level of environmental quality achieved.

To assist the Congress in determining what is the most appropriate division of effort among the different levels of government, our working paper reviews a set of broad economic guidelines. These guidelines argue for a division that promotes levels of protection and types of programs that are efficient and also equitable.

By efficiency, we mean that a program should balance benefits and costs, that benefits should be achieved at the lowest cost possible, and that benefits should accrue to the people and groups who place the most value on them. By equity, we mean a fair distribution of benefits and costs.

For example, equity may imply that the costs of environmental programs should be borne by those with responsibility for the problems to the extent that they are able to do so. Equity also implies that the benefits of environmental programs should be evenly distributed among different groups.

In general, the level of government best suited to running environmental programs is the level that is best able to assess costs and benefits accurately and to act on that assessment to produce environmental programs that are both efficient and equitable. Levels of government typically vary in their abilities to do this.

Smaller units of government tend to be closer to the environmental problem and to the persons and firms affected. As such, they may have better information on local circumstances and thus be able to assess costs and benefits more accurately. If so, they may be able to provide programs that better address specific local problems and circumstances. Smaller units of government may also have an advantage in terms of flexibility and the ability to provide more innovative solutions to environmental problems. These same characteristics may also enable lower levels of government to be more responsive to equity concerns.

Larger units of government, on the other hand, may be able to provide more efficient and equitable environmental protection under certain circumstances. If a substantial number of people and firms receiving benefits or incurring costs under a program are located outside the boundary of a jurisdiction, it is less likely that the local government will take into account the preferences of these groups and accurately assess the level and distribution of the costs and benefits.

In addition, some activities require substantial amounts of technical information. Small governmental units may not be willing to incur the costs of developing or acquiring this information. Finally, a program may have economies of scale in administration or construction, as in issuing permits or building wastewater treatment plants. If so, then larger government units may be better able to capture these economies and provide lower-cost service.

The degree to which these guidelines will give preference to one level of government over another depends on the specific program activity and environmental problem. Consider, for example, the task of setting standards. Variations in local standards allow flexibility in responding to unique regional circumstances, and allow the adoption of environmental quality levels that reflect local benefits and costs. On the other hand, uniform national standards provide a minimum standard of health for everyone, and thus may be justifiable on other than efficiency grounds.

As another example, it is often assumed that the governmental unit responsible for daily implementation of a program is in the best position to develop the most appropriate methods for funding it. This may not always be equitable and efficient. The costs of program management and compliance imposed by Federal regulations may be substantial at the State and local levels.

The burden of complying with these regulations may also be unevenly or unfairly distributed among jurisdictions; if so, then additional Federal support may be justified on the basis of equity and as a mechanism for persuading State, and local governments to comply with national regulations.

That, Mr. Chairman, ends my testimony. Thank you very much.

Chairman GLENN. Thank you very much. We appreciate the report and the work that has been done on it; it will be included in the record in its entirety. We appreciate your response to our request to do the report for the Committee.

Would you use the criteria you laid out in the second half of your testimony and the report, to evaluate the allocation of the responsibility you described in the first half? In other words, how efficient and equitable is our current distribution of responsibility for environmental programs?

Mr. SCHWARTZ. I am afraid that is a difficult task and one which we have yet to fully finish. That really is the topic of the next part of our study which we will be doing for you.

Chairman GLENN. Let me put it a little differently. I was sitting here speculating that one of the questions we should send to all the witnesses this morning and ask for their comment on is a bottom line threshold question. The actual environmental cleanup and protection is the bottom line. We want to clean up the environment today, and we want to protect it for the future. This is our overall objective.

Now, has the policy of transferring Federal responsibilities back to State and local governments made the cleanup and protection of the environment more difficult, or has it enhanced achieving that objective? What is you opinion?

Mr. SCHWARTZ. As you were talking, I was thinking about the testimony this morning about the leaking underground storage tanks. I think that may be an area where the costs at the local level are very high. I have no way of measuring the benefits myself, but as an economist I would want to look at what the relationship between the benefits of protecting the environment through these kinds of measures of having liability insurance, double lining on tanks and so on, is compared to the cumulative costs of all the people who have to do that.

Mr. DOWER. I might add that your questions is quite broad and intensive, looking across the whole list of environmental problems. I think there are clear successes in certain areas, where the delegation process has worked to the advantage of the environment. I think we see that in declines in air quality pollutants in many categories across the United States. I think you could point to that as success.

I think we also see successes in the Federal-State relationships that have develop in surface water discharge systems. I think we could point to successes.

I think also we have heard today of growing tensions and the potential for some failures, and it is partly that which we hope to get to in the final phase. But I think your question does require looking across a lot of programs and see where we have won and where we have not, and maybe trying to draw some conclusions or themes from those successes and failures.

Chairman GLENN. In other words, we have two separate objectives here. We want to make sure we get the environment cleaned up, and we have a policy that says we are going to turn as many functions of the Federal Government back to State and local areas as we can. I do not necessarily quarrel with that second goal. I think we have had too many things fall under Federal control. But a lot of these problems were or are under Federal because of the State or local governments had or have not taken action. So we are caught on the horns of a dilemma. We want to turn back what we can, but we want to make sure that the ultimate goal of making the environment better is not made more difficult by this turnback of responsibility to the local or State governments. That is what I am getting at here, and I think that it is a bottom-line question—quite apart of whether we want more federalism or less federalism. We do want a cleaner environment, we know that.

We heard today that both small business and local government feel overburdened by Federal environmental regulations. That does not come as news. We have heard a lot of that before, all of us in public office get that all the time. EPA gets it, everybody else gets it; it is nothing new.

What other information would we look at to determine, based on your criteria, whether the allocation is efficient or fair at different levels of government? Are there any other criteria? You bring up some of the economic criteria in your report. Are there other criteria we should be looking at?

Mr. SCHWARTZ. I am sure there are. Economic criteria, I am sure you know, are only one set of guidelines. Certainly, the political questions of what level of government is going to be most responsive to both the costs and the benefits of environmental cleanup. Other criteria might include, as one would expect, health standards and other questions of ecological standards.

Our criteria are—and I do not want to claim that they are easy to measure, either, but perhaps more quantifiable than some of the other criteria one might use.

Chairman GLENN. I think we better get a grasp of the overall impact of Federal regulations—those from EPA and other ones that townships and communities and small entities of government are faced with. We might very soon reach a point where the regulatory burden in all these areas combined is so great that local communities are just going to ignore the law——

Mr. SCHWARTZ. I think that is——

Chairman GLENN [continuing]. Because they do not have the wherewithal, the people, the volunteers who were supposed to take over, to pick up the load.

Mr. SCHWARTZ. I think you made——

Chairman GLENN. Is that a possibility, from your view of it?

Mr. SCHWARTZ. I think that is certainly a possibility and, from the testimony that I listened to this morning, you may find the buck being passed back up from the smaller townships up to the county level and then up to the State and eventually to the Federal Government. In fact, as I understand the history of the environmental movement, that in a sense is what happened, that initially the problems were being addressed locally and as time went by the problems got worse and the costs of cleaning it up got worse and it just kept getting bucked up the system. I think we may be seeing that again.

Chairman GLENN. What do you say in the CBO paper as to the Regulatory Flexibility Act? Do you suggest any changes to it?

Mr. SCHWARTZ. We do not specifically suggest any changes. We do address the Regulatory Flexibility Act in the sense that I think others addressed it this morning. The spirit of the Act I think is well taken and fully within the spirit of the criteria that we analyze in our paper. As we see it and others have, the problem is really in the implementation of what are very difficult decisions that do not fall well into these criteria.

Chairman GLENN. Do any of the staff have any questions?

We thank you. We will be having more questions for you, I am sure. We appreciate your cooperation in producing the working paper, and I understand it is released for public consumption. We appreciate your work on it.

What was your name again?

Ms. SUSSMAN. Frances Sussman.

Chairman GLENN. Frances, you did not comment this morning. You were the one who did a lot of the work on the report, as I understand. Do you have any comment on what your boss has said here this morning?

Ms. SUSSMAN. No, only——

Chairman GLENN. At the peril of your job only, that is all.

Ms. SUSSMAN. Fortunately, I do not have to imperil my job.

Mr. SCHWARTZ. She did an excellent job on this and I would say that, while we sit up here and speak the words, it was really Frances who wrote the paper.

Chairman GLENN. I have not read it yet. I just got one copy of it here this morning, of course, and so I do look forward to going through it. We appreciate your work on it, and we will be looking at it and submitting more questions to you. As always, when we are dealing with CBO, we appreciate the prompt response we usually get. We appreciate it very much.

Mr. SCHWARTZ. Thank you.

Chairman GLENN. Thank you very much.

The Committee will stand in recess subject to call of the Chair.

[Whereupon, at 12:45 p.m., the Committee was in recess, subject to call of the Chair.]

# STRUCTURE AND PERFORMANCE OF THE REGULATORY REGIME

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MONDAY, OCTOBER 3, 1988

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Committee met, pursuant to notice, at 2:05 p.m., in room SD-342, Dirksen Senate Office Building, the Hon. John Glenn, Chairman of the Committee presiding.

Present: Senator Glenn.

## OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order.

Today, in the Committee's third hearing on the subject of regulatory reform, we will examine the process that coordinates and controls regulatory agency rulemaking focusing on Executive Order 12498. It was issued in 1985 and designed to extend regulatory review to the earliest stages of the regulatory process.

Executive Order 12498 complements the regulatory clearance process established in 1981 with the promulgation of Executive Order 12291. Under this earlier Order, proposed rules are subjected to a cost-benefit test and must be cleared by OMB, the Office of Management and Budget, before being published in the Federal Register.

Executive Order 12498 builds on that regime by granting OMB the authority to clear, on a yearly basis, intended significant regulatory actions, as well as those already underway.

There are clearly advantages to centralizing control over the regulatory process. One advantage of a front-end review is the coordination of rulemaking across agencies. By directing agency heads to submit annually their regulatory plans for the following year and then circulating those plans in the form of The Regulatory Program of the United States Government, OMB is able to reduce overlapping or conflicting rules.

The Regulatory Program of the United States Government is this compendium that I am holding up here for all of you to see. It details all the different regulatory procedures which the different agencies and departments have gone or will go through—in this particular case between April 1, 1988, and March 31, 1989.

Another advantage of the regime established by 12498 is that it encourages the development of regulatory priorities. With limited financial and human resources, it is vital that the Federal Government use those resources as wisely as possible.

Indeed, agenda-setting and coordination were two recommendations this Committee made after an intensive study of regulatory policy in 1977.

Now, I hate to say so, but that was the last time that such a study was provided, prior to hearings that we have had this year. The aim of this hearing is to see how successful the current regime has been in achieving the goals we identified in 1977.

Now, I recognize, however, that the clearance process under Order 12498 creates numerous opportunities for abuse and delay—especially with the Order's extension of regulatory review at the pre-rule making stage. An open question, one I want to address in this hearing, is how much power should OMB have over executive agencies.

Some of the most important regulatory agencies are charged by their organic statutes to protect the public health and safety. The Senate confirms officials and the agencies retain technical personnel to see that these mandates are carried out.

We must insure that OMB does not over-step its bounds as a coordinator and facilitator of regulatory process and in so doing displace Congressional mandates of authority.

Documents and testimony from Senator Kennedy's Labor and Education Committee hearing on OSHA last April offers us an example of the influence OMB can bring to bear on agency regulations.

That hearing record suggests a battle between OMB and OSHA scientists over a number of important health standards. Those regulations included methods of compliance for permissible exposure limits; protection of health workers against infectious blood-born diseases, which is a known carcinogen; and a lock-out/tag-out rule drafted to protect workers from being maimed or killed by machines that they are in the process of repairing.

In these cases, it appears as though OMB used the 12498 review, in conjunction with the process established by Order 12291, to weaken regulations, as well as to delay timetables for their implementation.

Executive Order 12498 may offer other unique opportunities for abuse as well. Since the Order gives OMB the authority to clear regulatory actions before a rulemaking record is established, the possibility exists that rules are quashed in their infancy before they are subject to real public comment or have the opportunity to meet a cost-benefit test.

In the course of today's hearings I hope we can identify ways to keep the benefits of the current regime while eliminating opportunities for abuse. We will have a new president entering the White House in January, and I think it is all the more important for us to perform this kind of an assessment now. We hope it can be of guidance to the new Administration.

Today we will seek testimony from two panels. On the first panel we will hear from Joan Claybrook, President of the Public Citizen Litigation Group.

We will also hear from Richard Wegman, who, as a former staff director of this Committee, directed our 1977 study on regulatory reform, and Professor W. Kip Viscusi, from Duke University's Department of Economics.

On the second panel we will hear from James Miller III, Director of OMB, Office of Management and Budget. Mr. Miller will be accompanied by Sheldon Plager, Administrator of OMB's Officer of Inforamtion and Regulatory Affairs, which is responsible for clearing executive agency regulations under the 12498 process.

I look forward to hearing their views. We will try to find the balance between making certain that all of the mandates of the law are carried out and doing so in the most expeditious way.

So, if the first panel would take their places, please, Ms. Claybrook, Mr. Wegman, and Professor Viscusi.

We welcome you all to the hearing today. Ms. Claybrook, if you would lead off, we would welcome abridgment of lengthier statements today so we get the main points and have as much time for discussion as we possibly can. In any event, your entire statement will be included in the record. Welcome to our hearing and we look forward to your statement.

## TESTIMONY OF JOAN CLAYBROOK, PRESIDENT, PUBLIC CITIZEN LITIGATION GROUP, WASHINGTON, DC,[1] ACCOMPANIED BY DAVID VLADECK, SENIOR ATTORNEY

Ms. CLAYBROOK. Thank you very much, Mr. Chairman, for the invitation to appear today. With me today is David Vladeck from our litigation group. He is a senior attorney and has litigated a number of cases involving the Office of Management and Budget interference in the rulemaking process.

As the Committee is aware, this Administration has centralized control of the administrative process in the Office of Management and Budget to an unprecedented degree. Executive Order 12498 completes the shift in the locus of regulatory decision-making begun by the first Executive Order of 1981, Executive Order 12291, from the regulatory agencies to the Office of Management and Budget.

Under these two executive orders and the Paperwork Reduction Act, OMB now exercise extensive control over the administrative process from start to finish and with this power OMB has managed to repeatedly cut back on health and safety regulations, both weakening regulations and delaying their issuance and it is in this area that Public Citizen specializes.

Executive Order 12498 plays a key role in giving OMB this control. Taken alone, the order accords OMB the power to shape the agenda of the Executive Branch agencies since it directs OMB to review on an annual basis each agency's policies, goals and objectives for the coming year and information concerning all significant regulatory actions underway or planned.

OMB may return part or all of a proposed agency regulatory program that it views as inconsistent with the Administration's policies and priorities, or out of line with the requirements of section two of the Executive Order 12291, namely that administrative decisions must be based on adequate information concerning the need for and consequences of proposed Government actions and that agency priorities, "will maximize the aggregate net potential benefit to society when the societal costs and benefits are compared."

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[1] See p. 360 for Ms. Claybrook's prepared statement.

With this control over the agency's budget, including an agency's resources for research, data gathering, surveys and other types of information development that are essential to doing these kinds of analyses, there is little likelihood that agencies will fight with OMB on any particular regulatory initiative.

But Executive Order 12498 cannot be examined in isolation. While it focuses on the development of an agency's priorities with Executive Order 12291 and the Paperwork Reduction Act, they give OMB enormous control over the final work product.

Under Executive Order 12291, all Executive Branch agencies must send proposed and final regulations to OMB for prepublication review. OMB can prevent an agency from publishing a final rule until OMB has given the agency its comments and the agency has responded to OMB's satisfaction.

Since the Executive Order neither imposes enforceable time limts for the completion of OMB review nor limits the number of times that OMB can disapprove the agency's actions, the order essentially gives OMB de facto veto power over agency rulemaking.

OMB's authority over agency regulations is further bolstered by the Paperwork Reduction Act which givers OMB authority over regulations that require collection of information. The Act confers on OMB the authority under certain circumstances to curb an agency's efforts to furnish itself with information if OMB concludes that the collection is not necessary for the performance of the agency's functions.

Taken together, these powers give OMB substantial if not decisive control over an agency's rulemaking process from start to finish. Under the two executive orders, OMB has the power to supervise the development of all regulations and under the Paperwork Act, can control the ability of an agency to gather information, which, obviously, can have a profound impact on the ability to carry out the substantive mission of the agency.

OMB's hegemony cannot be doubted as Jim Tozzi, the former Director of the Office of Information and Regulatory Affairs at OMB noted, "The Government works using three things—money, people, and regulations. The agency must get all of these from OMB."

When asked to name an agency that promulgated a regulation over OMB's objections, the administrator at that time, who is now Judge Douglas Ginsburg, responded, "I don't think that there is such an instance; no, none." Or, as the current OMB director, James Miller, put it, "If you are the toughest kid on the block, most kids won't pick a fight with you."

The Executive Order established things quite clearly. Indeed, under this troika of authority, OMB review and approval is now required at least four times—four times—before a regulation can be issued and enforced; first, when the agency seeks authorization to place a matter on the regulatory agenda; second, when the agency publishes the notice of proposed rulemaking; third, when the agency publishes the final rule; and fourth, when OMB conducts its final review under the Paperwork Reduction Act.

At each juncture the agency bears the burden of demonstrating that its proposal is not only consistent with the statutory mission assigned to it by Congress but also with the substantive criteria laid out in the executive orders, which mandate that agency rules must be consistent with the Administration's policy and meet a stringent cost-benefit criteria.

If in OMB's view the proposal fails to meets these conditions, the agency cannot regulate and it has no course at all except to withdraw its initiative. With so many opportunities to "Just say no" to a regulation, it is hardly surprising that OMB has managed to choke off all but a trickle of critical life-saving health and safety regulations.

Public Citizen has long voiced its opposition to OMB control over this process for three reasons. First, OMB now has the power to displace decision-making authority that Congress assigned to the agencies with their expertise, not to unaccountable economists at OMB. And incidentally, Public Citizen did a survey not long ago of the staff at OMB that do this review and found that most of them had very little, if any, expertise. Most were economists and most had never been involved in regulatory matters. Not only is this displacement unlawful, but in our view, it is bad policy. It makes little sense for untrained OMB bureaucrats to have the power to second-guess the highly technical judgments made by agency experts.

Second, OMB control is inherently undemocratic. Our administrative rulemaking process is a model of openness in the United States. The public has an unqualified right to participate in rulemaking and all agency decisions must be made on the basis of the public record. By contrast, OMB control is often exerted behind closed doors with no opportunity for public participation and often no public record of what influenced the decision. This kind of secrecy is an anathema to a democracy like ours.

Third, OMB control denies Congress its vital oversight role. Our Constitution rests on a system of checks and balances and the framers wisely placed a check in the President's exercise of his authority under the "Take Care" clause of Article II through the Congressional power to oversee the executive branch's work of law execution. But under Executive Order 12498 Congress will simply never know when an agency sought to develop a regulatory initiative but was blocked from doing so by OMB. The whole process generally takes place outside of the public view.

The Committee asked particularly about the potential for abuse for "rules in their nascent state" under the Executive Order 12498. In this critical respect, this Executive Order is far more insidious than its predecessor. Since Executive Order 12291 only applies to proposed and final rules—which are typically preceded by advance notices of proposed rulemaking and other public announcements—the public at least has an idea of when OMB involvement leads an agency to shift its ground or to back away from taking any regulatory action. That is why Congress has been able to uncover numerous examples of OMB's displacement of agency authority.

For example, Congressional hearings and other sources have disclosed that OMB forced OSHA to delete portions of its standard governing worker exposure to ethylene oxide, Public Citizen filed a lawsuit in this case and eventually succeeded. OMB pressured OSHA into delaying and weakening its hazard communication rule, another area where we sued. OMB forced EPA to withdraw proposed rules concerning the banning and phase-down of asbestos use and instead directed EPA to refer action in that area to other agencies, despite EPA's conclusion that its own action was required by the law. And there are many others.

Executive Order 12498, in contrast, operates wholly outside the public view. By definition, since OMB clearance is an indispensable pre-condition to even listing a particular issue on an agency's agenda, if OMB returned the proposed agency policy initiative under 12498, that would seal the fate of the initiative because this would occur before the agency had begun to gather enough facts to make its case.

Consequently, some—perhaps many—rulemaking initiatives will simply disappear and neither Congress nor the public will ever have a clue that the agency, if left to its own devices, would have explored the facts and considered taking regulatory action.

Finally, Mr. Chairman, the Committee requested our views about what future administrations ought to do in terms of structuring a regulatory review process. In our view, the first principle is that there must be a clear line drawn between the management functions of a regulatory review program, which can be quite valuable, and the usurpation of agency authority, which is unwise and unlawful.

Thus, I would endorse a role for OMB in coordinating the work of agencies that have overlapping responsibilities, but I would oppose any system that vested authority in OMB to substitute its judgment on substantive matters for that of the agency. And indeed, that is why Public Citizen fought so hard to stop the enactment of the regulatory reform package that the Administration sent up in 1981 because it would have put into law much of what we find in these executive orders and we thought that was bad public policy.

Moreover, the process needs to be simplified. Applying this Administration's own cost-benefit principles to regulatory review, the present system—which has at least four layers of review—is costly and bureaucratic without any benefit to the Nation. Regulatory review should be prompt and not the secret, time consuming openended process that is now the rule.

Attention must also be paid to the procedures under which OMB operates. The time has come to substitute sunlight for the shroud of secrecy that has masked most of OMB's regulatory oversight work. While we recognize that the Executive Branch generally must be allowed the freedom to exchange internal views off the record—and this is important—on matters affecting the development of regulations and setting an agency's priorities, OMB's comments should be a matter of public record and we should know where they stand.

All documents reviewed by OMB and all records of all contacts between OMB and anyone outside the Government should be placed in the public record just like they are when an agency meets with people outside the Government agency.

To the extent OMB wants to file comments with the agency, these comments should be a matter of public record, and Congress should overrule *Wolfe* v. *Department of Health and Human Serv-*

*ices,* which held that records which revealed the extent to which a substantive delay in issuing regulations was attributable to OMB review were exempt from disclosure under the Freedom of Information Act. We think this is ridiculous.

Finally, as part of its review of the regulatory process, Congress should not overlook the Paperwork Reduction Act. The automatic sunset provisions of that Act, applicable to information gathering rules, added by the 1986 amendments, soon become operative and Congress needs to reexamine the wisdom of having information collection requirements such as the reporting of defective cars to the Government or adverse drug reactions that have to be reported, to have these lapse every 3 years. We would urge that this sunset provision be revoked.

Congress also needs to examine whether the Act warrants clarification with regard to whether OMB can exert substantive control on an agency's regulatory programs through its powers under the Paperwork Act. As this Committee knows, there has long been concern that OMB is over stepping its authority by interfering with an agency's substantive missions through disapproving key information collection requirements.

Just such an instance recently opened up in the courts in a case in which Public Citizen was a party involving the OSHA hazard communication standard. The United States court of appeals for the third circuit held that, "Nothing in the Paperwork Reduction Act suggested Congressional intention to allow OMB in the guise of regulating collection of information, the authority to second guess other Federal agencies with respect to the kinds of disclosure needed to accomplish the substantive policies entrusted to such agencies."

OMB disagrees with this holding and consequently it is likely that there will be more litigation over OMB's substantive powers under the Act unless Congress clarifies this issue.

That concludes my prepared statement, Mr. Chairman, and we would be happy to resond to any questions.

Chairman GLENN. Thank you very much. I think we will have all of our testimony first.

We are glad to welcome now Mr. Richard Wegman. I go back far enough on this Committee to feel that he should still be sitting back here as the staff director instead of out in front giving testimony. He did outstanding work on the Committee and was here during the tenure when our chairman was Senator Abe Ribicoff, another outstanding leader. I came on the Committee during that time.

So Mr. Wegman, we are glad to welcome you and welcome your testimony.

## TESTIMONY OF RICHARD A. WEGMAN, PARTNER, WEGMAN AND HOFF, WASHINGTON, DC [1]

Mr. WEGMAN. Thank you, Senator Glenn. It seems a bit strange to be sitting on this side of the witness table rather than on the other side of the witness table, but I will try to give you the benefit of my perspective from the days when I sat on that side.

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[1] See p. 384 for Mr. Wegman's prepared statement.

Chairman GLENN. This just means we will hammer you good when we come to questions.

Mr. WEGMAN. Very good. As I understand it, when you asked me to testify today, you particularly wanted a brief retrospective on the Committee's efforts during the 1975 to 1981 period on regulatory reform legislation, and particularly the question of OMB oversight of Federal regulations.

This was a topic that was considered quite extensively by the Committee during those years, both in the course of its study on Federal regulation and subsequently in connection with the omnibus regulatory reform legislation that the Committee had before it.

In late 1974, shortly after succeeding to the Presidency, Gerald Ford asked the Congress for authority to undertake a broad-scale study of the Federal regulatory system. After considering the Administration's request, this Committee decided in the spring of 1975 to undertake its own study of Federal regulation. This study was conducted jointly by the Governmental Affairs Committee and the Senate Commerce Committee and it took 4 years to complete. As I mentioned, a major topic addressed in this study was the coordination issue and the potential role of the President and/or OMB. The report considered what role OMB should play as, "The preeminent coordinating mechanism of the Executive Branch."

However, the report stopped short of making specific recommendations for expanding the role of OMB in overseeing Executive Branch regulatory agency decisionmaking. In fact, the report advocated additional autonomy for the independent, non-Executive Branch regulatory agencies by recommending that such agencies be exempt from any prior clearance by OMB or other Executive Branch departments in submitting their legislative recommendations, testimony or comments to the Congress.

On a Government-wide basis, the Committees recommended that an enhanced coordination role be given to the General Accounting Office. In cases of organizational conflict or inconsistent remedies, the committees recommended that GAO be directed to advise Congress on appropriate legislative action. They also suggested that Congress become more actively involved in reviewing planning and priority setting by the agencies.

As I recall, there was considerable skepticism on both Committees at the time about a potentially stepped up role for OMB in regulatory decisionmaking. On the one hand, members of the Committees clearly recognized that conflicts, overlaps or inconsistency could exists between regulatory programs and that some mechanism was needed to balance out the competing priorities and to iron out conflicts. On the other hand, there was concern about impact on the administrative process and particularly what might happen to the notice and comment provisions of the Administrative Procedures Act if direct political intervention were to take place, either before the public comment period began or after the close of the public comment period.

There was also a good deal of concern over the potential displacement of authority of regulatory officials whose ability to carry out their statutory responsibilities might be impaired. After the study was completed, Chairman Ribicoff, Senator Charles Percy, the Ranking Minority Member, and a number of other members of the Committee introduced omnibus regulatory reform legislation which was designed to streamline the administrative process, clarlfy separation of functions between agency enforcement and adjudicatory functions, and limit the tenure of administrative law judges.

During its hearings on the bill, the Committee devoted a great deal of time to the coordination issue. It was probably the single most difficult question the Committee faced. Toward the end of the Committee's work—and I can only go up through the end of the 1980 Congress, Senator; I left the Hill at that time—a compromise approach emerged which would have provided for OMB to, "monitor" the rulemaking functions of Executive Branch regulatory agencies. Time, however, did run out at the close of that Congress before the bill could be brought to the floor, and the legislation was never enacted.

I'm not going to dwell at any length on the oversight and coordination programs that have been put in place by executive order. The Committee is certainly familiar with them and other witnesses will touch on them. Essentially, a mechanism has been put in place in the Executive Office of the President for overseeing the functioning and operation of Federal regulatory programs.

In my view, this mechanism goes well beyond anything that was contemplated by the Congress at the time it was considering the regulatory reform legislation in the late 1970's. These Presidential directives provide for Executive Branch regulatory agencies to submit goals, priorities, and program agendas to OMB in advance, to prepare regulatory analyses on all major regulatory initiatives, and to determine that any given regulatory venture is consistent with the goals of the Adminstration.

In theory, there is little wrong with these objectives. There is no doubt that regulatory agencies—particularly those in the Executive Branch—constitute part of an elected administration and ought to further its goals and priorities. Morever, if is no doubt useful for agencies to anticipate the costs and benefits of regulatory action before proceeding to implement it.

In practice, however, the process does pose a number of problems.

One, the problem of delay. Delay has always been endemic in the regulatory process, but seems to be much more so as a result of the new regulatory management scheme. At EPA, for example, 86 out of 169 regulations submitted to OMB were delayed beyond the time allowed under Executive Order 12291. The average delay has been 91 days; total delays amounting to 311. These delays were documented in a recent 1986 decision by the U.S. District Court here in the District of Columbia. Most other agenices subject to the Executive Order have encountered similar problems.

Second, displacement of authority. There have been a series of reports and hearings, both by this Committee and by the Oversight and Investigation Subcommittee of the House Energy and Commerce Committee, documenting how OMB action has suspended or delayed health, safety, consumer and environmental regulations. The report and hearings review OSHA's grain dust regulations, EPA's regulations governing manufacture and sale of asbestos containing products, the short-term exposure limit for ethylene oxide, and a number of other instances where OMB's view was effectively substituted for that of the agency.

Third, the problem of unfulfilled statutory mandates. This was a topic National Acadancy of Public Adminstrators report focused on. In its conclusions NAPA pointed out that laws enacted in one spirit—that of regulatory zeal—are being administered in quite another spirit by the Reagan Administration. The OMB bias against new regulatory activity can other conflict with the statutory mandates of these agencies.

Finally, the problem of undermining the administrative process. The NAPA report indedifies several of the basic purposes in the Administrative Procedures Act, including providing the public with an opportunity to participate fully, providing the public and the Congress with an opportunity to fully understand the basis for decisions that are made, assuring that decisions made by the agency are reasonable, ensuring that decisions reached by the agency are made according to criteria intended by law, and finally, assuring that the entire process is open to the public and to judicial scrutiny.

The Executive Order 12291 and 12498 process, by involving officials not directly charged with administering the underlying statutes, by introducing off-the-record discussions on matters central to the decisionmaking process, and by introducing potentially extraneous factors for consideration such as cost-benefit criteria, does risk running afoul of at least the spirit, if not also the letter, of the Administrative Procedures Act.

Mr. Chairman, the next Congress and the next administration will have to deal with these concerns. If they do so, they would complete the process begun in the mid-1970's by our Committee and others when Congress and the Administration first focused seriously on the need for better coordination and management in the regulatory field.

It is unfortunate that Congress failed to respond to the need for legislation at that time, because this allowed the Executive Branch to proceed on its own. The pendulum has now swung too far in the other direction. In the interest of better regulatory coordination and management, widespread political intrusion into the regulatory process now takes place routinely. The entire process has become cumbersome and excessively bureaucratic, and questions are being raised about how the rule of law is being carried out at many agencies.

I hope very much that the next administration will work with the incoming Congress to craft a statute that addresses these concerns. Let me just briefly touch on two or three matters that I think such a statute ought to address.

First, should regulatory analysis be employed, and if so, to what extent? As I noted earlier that regulatory analysis seems to have inhibited a number of health, safety and environmental initiatives. In my view, regulatory analysis enables agencies to anticipate the consequences of proposed action, but there is a major difference between using regulatory analysis as guidance, and mandating that an agency choose the single alternative involving the least net cost to society. In my view, the analysis should simply serve as one factor among many that the agency considers before it decides how to proceed.

Secondly, how large should the OMB oversight office be? What magnitude of resources should it devote to the task? Much of the displacement of authority problem has arisen because the OMB bureaucracy has grown far larger than it should be. There is no need for OMB to superintend every aspect of the regulatory process from inception through implementation. I would shift the locus of the regulatory decision-making back to the agency head, and limit OMB to the role of arbiter and coordinator in cases of conflict or inconsistency. In addition to streamling the process, this would make it much easier for Congress—acting through its authorizing Committees—to hold agency officials accountable for decisions that are made or not made. Today it is often very difficult to determine who in the Administration is responsible for a decision or non-decision and this, of course, undermines political accountability.

Third, should OMB become involved in particular regulatory decisions, and if so, on what basis? Here again, in my view, OMB involvement in particular decisions should be the exception rather than the rule. Only where a specific action is likely to conflict in a major way with the mission or goal of another Administration program or agency should OMB become involved. I do not think that should happen more than perhaps 15 or 20 times over the course of a President's term. In such an instance the OMB involvement should be as open as possible and take place as early in the process as possible. Interested parties should have an opportunity to respond or rebut the position presented by OMB. In the exceptional situation where the conflict could not have been identfied until after the close of the notice-and-comment period, and OMB weighs in at this later stage, I would suggest that an additional comment period, not to exceed 15 days, be provided so that interested parties would be able to respond to the OMB position.

Mr. Chairman, we have been seeking an appropriate regulatory coordination mechanism for more than 15 years. If the next Congress can succeed in striking the proper balance, a major area of conflict between Congress and the Executive Branch can be eliminated, and regulatory programs can resume functioning as I think Congress intended when it enacted the APA back in 1946.

Thank you very much, and I would be pleased to answer any questions.

Chairman GLENN. Thank you very much. Professor Viscusi, we will have your testimony before we proceed with the questions for the panel.

## TESTIMONY OF W. KIP VISCUSI, GEORGE G. ALLEN PROFESSOR OF ECONOMICS, DUKE UNIVERSITY [1]

Mr. VISCUSI. Mr. Chairman, thank you for the opportunity to testify here today. My name is W. Kip Viscusi and I am the George G. Allen Professor of Economics at Duke University.

I would like to begin my testimony by commending you for holding hearings on this issue. Regulatory oversight is not a particularly flashy topic since it is somewhat abstract in character. Nevertheless, the design of this oversight process has fundamental implications for how a broad range of Government regulations affect our lives.

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[1] See p. 401 for Mr. Viscusi's prepared statement.

My background is in the regulatory oversight area, and it began in the Carter Administration. I was Deputy Director of the President's Council on Wage and Price Stability, which was the branch of the Executive Office of the President that was assigned responsibility for making regulatory filings on behalf of the Executive Office of the President. In addition, this process was accompanied by the activities of the Regulatory Analysis Review Group, which was a non-binding review process for selected major regulations.

During the Reagan Administration I have been involved in the regulatory process in different capacities. First, I have served as a consultant on various regulatory analyses prepared for OSHA and EPA. In addition, after the OSHA hazard communication regulation was rejected by OMB and then appealed by OSHA to Vice President Bush, I was asked to evaluate the substantive dispute between the two agencies. This involvement gave me an opportunity to observe first hand the operation of the current oversight process.

In addition, much of my academic research has been directed at refining my estimates of the value of life. These numbers are now widely used by OMB and in the benefit calculations performed by risk regulation agencies.

The most fundamental issue is whether there should be some form of regulatory oversight mechanism to review, and coordinate regulatory activities. All Presidents since President Ford have recognized the need for such a process and I think there can be little doubt that there is a need for executive oversight. Special interest agencies that are not subject to any outside review other than judicial reviews for overstepping their mandate do not always act in the national interest. There will be a tendency for these agencies to advance their parochial interests rather than the national interest.

Congress does not review each regulation that is proposed and does not even have a formal review role. In the absence of an executive oversight process, the White House and the rest of the Exeuctive Branch would not have a review check, either. I believe that the review process is essential, simply to get the agencies to advance the national interest rather than the interest of special groups.

If there is a need for an oversight institution, the issue then becomes which institution should undertake this function. Before the Reagan Administration, the main participants in the oversight process were the Council on Wage and Price Stability and the President's Council of Economic Advisors. The transfer of these functions to the Office of Management and Budget is a desirable change from the standpoint of giving the oversight process more leverage. The Council of Economic Advisors, for example, remains largely an advisory body with no strong institutional base of its own.

The one potential danger from this institutional shift is that there may be greater politicization of the oversight process. Many of the participants in earlier eras of the oversight procedure were academic economists on leave to the Government who were interested primarily in developing sound economic analyses of policy issues, not in advancing a political agenda. The thorough nature of the regulatory analyses that were prepared also attracted some of the leading career Government economists to the regulatory review staff.

Although the entire Carter Administration regulatory oversight staff was transferred to OMB at the start of the Reagan Administration, many of the Ph.D. economists have left and these have not been replaced. My general sense is that the character of the operation has changed substantially as well, as there is less refined analysis of policy issues than there had been in the past. Thus, the process that now occurs is less detailed in terms of its substantive content and as a consequence, it may be less likely to lead to correct decisions.

The criteria for evaluation that have been stated under Exeuctive Order 12291 are quite desirable from an economic policy analysis standpoint. Ideally we would like to assess whether the Government regulations best advance society's interests. Making such an assessment requires that we evaluate the benefits and the costs of these regulations, and provided that there are no specific legislative prohibitions against doing so, the regulations should also be subject to a benefit-cost test. We should not proceed with the regulation unless the benefits are greater than the costs.

For the most part, it is not the benefit-cost criterion that is applicable, but rather the dominant emphasis of the review process is on the importance of cost-effectiveness analysis, as an effort is made to find the least expensive means for achieving a particular policy objective.

I fully support the stated criteria for OMB review and I believe that better policies will result from application of these criteria.

One might raise the issues of whether in fact OMB truly applies such unbiased criteria or whether it simply manipulates such criteria to advance the political agenda of a particular administration. Based on my involvement in the OSHA hazard communication issue, which was a regulation that was issued despite OMB opposition, I believe that the character of the debate between the two agencies is exactly what we would want. The main issues at stake were how many additional injuries and illnesses would be prevented by the proposed labeling standard. The issue was whether the health benefits achieved would be worth the costs. Although I believe the functioning of the oversight process was exemplary in this particular instance, the general aura of secrecy breeds suspicion. The issue of making better known what OMB is actually doing is the most important topic for possible reform of the process. I will return to this issue in making my policy proposals.

The most recent addition to the structure of the oversight process is Executive Order 12498, which provides for OMB review of the regulatory agenda of the regulatory agencies. The prospect of this agenda review process was disturbing to many regulating agencies, but I believe that the reality of the review process has not had the sweeping effects that were feared.

It is difficult to kill a regulation at an early stage unless it is obviously undesirable. At the nascent stage there is little information about benefits and cost of the regulation so that it is difficult to disprove the agency's position that the regulation might be potentially desirable except in extreme situations.

Some of the original proponents of this agenda review process envisioned that it would eventually lead to a regulatory budget. I believe that the regulatory budget concept is not workable and should not be a long term objective. It is not particularly sensible to impose a budget since we should be interested in pursing all regulations with benefits to society that are in excess of the costs that we impose upon society irrespective of whether we have set a particular budgetary allotment for the agency.

It would, however, be desirable to establish a more meaningful discussion of the regulatory agenda of the different agencies. What I envision here is not a brief 5 to 10 paragraph description of each of the agency's programs that we now receive in the regulatory program of the United States Government. Rather, I would like to see a comparative analysis of how the agency will choose to allocate its resources over the coming years. What should be the emphasis on acid rain—The greenhouse effect—or more immediate risks to society from pesticide exposures? These are questions not so much for a secretive review process but rather for a more open policy debate, including Congress.

In addition, what is needed is not another executive order but a commitment by the leading officials of the agencies and by the Executive Office of the President to raise these issues in a meaningful way and to open them up for public debate. This suggestion is related to what is my main policy proposal regarding the oversight process.

The most important reform that is needed is to open up the current secretive reviews by OMB. After each review OMB should be required to make public a detailed discussion of either why it has approved a regulation or why it disapproved the regulation.

Preparing and disseminating such written assessments is important for several reasons. First, it forces the officials in the agency to think through what regulatory policies are in fact best as opposed to acting on what may be a political disposition against particular types of regulations. In many cases, one simply does not know the answer as to whether a particular regulation is desirable until a detailed analysis has been performed.

In the Carter Administration the preparation of such analyses served as the vehicle for fostering an often intense internal debate as to what our regulatory position should be By requiring that these analyses be made public, the agency will have a greater incentive to insure that the underlying policy analyses that form the basis for its regulatory actions are sound and can withstand public scrutiny.

Making these analyses public will also foster public debate on these issues and provide guidance both for individuals in the agency as well as for officials in other agencies of the proper approach to regulatory analysis. We will know why the Government has chosen a particular course, and if new information develops that might alter the attractiveness of the regulation, then it will be possible to assess what difference this information will make.

In effect, my proposal is to combine the best elements of this Carter approach and the Reagan approach. What I would like to see is the structure of the Reagan Administration process combined with the substantive emphasis of the Carter oversight process. There should be a greater emphasis on more detailed regulatory analyses, and OMB should make public the nature of its efforts to foster and open regulatory debate.

I would be happy to answer any questions you might have.

Chairman GLENN. Thank you very much. We appreciate your statement very much.

Professor Viscusi, when you were in the Carter Administration—and many of these things came before your group there—how much did you argue over politics versus the substance of what Congress had passed? Did politics creep into it? Was that taken into consideration as you considered these different agencies?

Mr. VISCUSI. I don't think we had as clearly stated an agenda so there was no position of the Carter Administration toward the New Federalism versus State-run regulations. When we looked at regulations it was more from the straight regulatory analysis standpoint as opposed to having a well-defined ideology of a President that we were applying to the regulations. Political factors entered at a subsequent stage when our analyses were used by White House officials in their negotiations with the regulatory agencies.

Chairman GLENN. Mr. Wegman—all of you, in fact, but I will ask Dick first—you stated in your testimony that the study on Federal regulation performed by this Committee in 1977, which you headed, raised a number of concerns about an increased role for OMB in regulatory decisionmaking. Specifically, the Committee was concerned that OMB could displace the regulatory authority of agency officials and that political intervention could undermine the administrative process established by the Administrative Procedures Act. Professor Viscusi also brought that up in his testimony.

Now, how has this worked out? How would you assess what has happened in the intervening years? To what extent has the regulatory review process created by these Executive Orders—12291 and 12498—borne out these fears?

Mr. WEGMAN. Let me just clarify something, Senator, to go back to your question. When I say that I think there was some concern about displacement of authority, this was a view held by a number of members, but it was not a recommendation that was placed in the study per se. The study came up with a series of recommendations, which I mentioned in my testimony—including, for example, in the case of independent agencies, that they be more independent from OMB control and that the coordination function be given to GAO—and I think these stemmed from the concern of a number of members about the potential intrusion of an agency as powerful as OMB directly into the regulatory process and the concern about displacement.

But I didn't want to leave the impression that somehow that concern about displacement of authority was in fact in the formal report of the Committee, because it was not laid out in precisely those terms.

I do think that some of those concerns have been borne out. The findings of several Governmental Affairs Committee reports, the findings of the House Oversight Subcommittee of the Energy and Commerce Committee, and the findings of the study that was done recently by the National Academy of Public Administration, do suggest that there have been a number of instances where agency authority has been, if not displaced, at least compromised to a considerable degree by the extensive involvement of OMB in the process, and that a number of matters have been resolved differently than they would have been had the decision been left to the agency.

Chairman GLENN. Ms. Claybrook?

Ms. CLAYBROOK. Mr. Chairman, I think it is one of the questions that we haven't raised and I think it is very important. What is the role of the cabinet secretaries? It seems to me that when the President appoints someone to head the Department of Transportation or Health and Human Services or any of these departments that report directly to the President, that their authority is displaced if OMB becomes a decision maker, and that is really what we are complaining about.

We think ought to be coordination. In the Carter Administration it was done through something called a regulatory council, which was participated in by all the regulatory agencies. They met all the time. And we were ordered by the White House not to issue regulations without coordinating with any other agency that was relevant and had something to say about what we were doing. And I think by and large that happened very well.

The second piece of coordination that occurred was—as Mr. Viscusi said—was to have a special review group in the White House look at those big decisions that are really overwhelmingly important, that cost a huge amount of money, that are enormously complex, very controversial, and as Dick said, there are about 15 or 20 of them in a four-year period.

That is what the Carter White House did. They had a special group that did an in-depth analysis of major rules. I had communication with that group and they challenged some of the things that we did and they asked for more information, and that was not unreasonable. But the decision was still the decision of the Secretary of Transportation. It was not the decision of the OMB, by some anonymous individual, who gives orders to Government officials who are appointed by the President and approved by the Senate.

The officials are now, today, told what their agenda is. The agenda is from the top down from OMB. It is not developed based on the empirical information, the facts, the circumstances, the needs of the public, the evaluation of factual information, and sent forward to show the particular issue that should be recommended or corrected.

This is particularly true in the health and safety area. It seems to me that one of the things that we have been kind of dancing around here and not mentioning is why is OMB so secretive? Why do they find it necessary to be secretive? It seems ridiculous. I think that the issue is that they have an agenda that has been imposed on the agencies and they have been doing this with secret communications. OMB serves as a conduit from the regulated companies. OMB translates that information and they become a surrogate and then they give orders to the regulatory agency. And that is essentially what this process has been all about and that is the reason there has been so much secrecy. This process does displace an agency's decision-making authority.

Chairman GLENN. The way you talked about it working before, though, isn't there just as much a tendency for politicization of the process when it works right out of the White House through working groups, as you mentioned, as there is in OMB? And how did you avoid that? Or did you avoid that?

Ms. CLAYBROOK. Well, first of all, in the Carter Administration, most of the things that you worked on did not go to that regulatory review group. As you say, in my case, I think two cases went to them—only two—out of all things that we worked on in a 4-year period, so that it wasn't an everyday event.

Here, today, everything that you do OMB controls so that you cannot even issue a fairly minor regulation or a correction without having to go through an enormously complex bureaucratic process. Although they are treated more quickly than in the early Reagon years, nevertheless you still must do it.

Secondly, OMB controls your budget, and I think that that is a very important thing to remember. And they are very arbitrary about it. So if I have a desire or need as an administrator to go forward to OMB to get a particular budget item approved and I am having a battle royal with them at the same time over some regulations, you know, they are going to be a little bit less sympathetic about my budget.

Chairman GLENN. Looking at it from a Government-wide standpoint, somebody has to coordinate someplace.

Ms. CLAYBROOK. The budgets or the regulations?

Chairman GLENN. Both, and it is OMB. Some of those regulations are quite expensive. How do you avoid having them considered by the chief coordinator of budget functions whether you like it or not?

Ms. CLAYBROOK. Well, most of the costs are not paid by the Government, but it is a cost to industry, and that is the reason, of course, that industry is so concerned about this. So it is not a governmental cost per se. That is not to say it is unimportant, but it is to say what is the that for the Government it is not a budget issue.

Secondly, I believe that regulatory analyses—as I think everyone at this table believes—should be done. I think that we should make the very best effort we can to understand the full cost, all the implications, the environmental implications, the implication for small business—we should understand the regulations before we issue them because they have the force of law.

But I don't think that because a rule does cost money necessarily means it should not be issued. And that is why it is a decision that should be a balanced societal decision, not just a numerical decision; not just dollars and cents.

The other piece of this is, of course, who is to say what is the value of life? Mr. Viscusi makes a specialty of making such an estimate. I find myself hard put to say that is right or wrong because the value of life is different to each and every person, and yet we are deciding on whether or not to have passive restraint air bags in cars or whether or not to have drugs taken off the market on the basis of an objective but who is to say what is the value of life. And it should not be balanced that way. It ought to be looked at from a societal point of view.

And the third issue is that we don't have a lot of data on the benefits. You know, we don't collect much of that data and in this Administration they have cut out most of that research. So you are asking an agency to make a decision without much information, without the authority or the money to do that kind of research and to make a numerical cost-benefit, least cost decision.

I think that is not only inappropriate but I think that the public doesn't benefit.

Chairman GLENN. Thank you. Professor Viscusi, in your written testimony you state that, during the Reagan Administration, the regulatory review process has shifted away from "substantive analysis."

You also note that many of the leading career Government economists that came to OMB during the Carter years have since left.

What do you believe to be the predominant basis for the regulatory analysis that OMB performs? Is it correct to infer from your statement that this basis is political or ideological as opposed to the substantive execution of the mandate of Congress?

Mr. VISCUSI. I think there is some ideological component in there in the sense that there is an emphasis on the New Federalism, which is a general belief that States should carry out the regulations as opposed to the Federal Government, irrespective of whether the national benefits are greater than the national cost. I think there has also been a great shift away from doing detailed economic analyses. I believe that there are only two Ph.D. economists left on the staff, and these are holdovers from the Carter Administration. All the other Ph.D economists have left and have been replaced by MBAs or Master's students out of public policy schools.

Because they don't have to go public with the detailed analysis, OMB officials have less of an incentive to carry out an analysis, and I liken what they do in analysis with perhaps being similar to what I do when I review an article for publication. You read the article and you try and find five things bad with it, and once you have done that you can stop. And it may be the same kind of thing with regulations. Because you don't have to prepare a detailed analysis, you just keep on examining it until you find a few things to fight about and win a battle in a meeting and once you have gotten that agenda for the meeting, you do not have to prepare an analysis. A better approach would be to place OMB in a more construcive role through comprehensive analysis of regulatory alternatives.

By not requiring them to perform a full-blown benefit-cost analysis at OMB, but instead letrting them just review regulations on more of an ad hoc basis without having to go public with the detailed analysis, we do not really know what they are doing. I do not know that they are abusing their power, but there is no way to ascertain whether they are or to prevent the abuse if it were occurring without having this public check.

Chairman GLENN. I think that when the original legislation was passed to set up OMB, Mr. Wegman would probably agree that we were responding to a lot of areas of potential conflict between different agencies of Government. We wanted to gather at one central point the arbiter of those concerns and also to take into account budgetary concerns. These are all legitimate functions to be coordinated some place, whether in a study group or a group out of the White House, as Ms. Claybrook describes, or a group such as you worked on when you were here before. But we wanted to establish one spot where all of that came together.

Now, I think what the concern has been—and this is not just a Democratic concern, I think it has been both a Republican and a Democratic concern—is that perhaps politics and ideologies have crept into OMB decisions more than is needed to just coordinate the different roles of Government.

Congress has set down some mandates in law that are supposed to be carried out—whether it is in the health and safety area at OSHA, pollution at EPA, or whatever. And, then we find that an administration that wants a policy of new federalism—wants to give many duties back to the state—or—wants a policy to let the functions of Government be deregulated—used OMB to do some of those things, quite apart from the mandate of Congress rather than operating through Congress to get the law changed.

So that has been a rising concern, and I would say that is not just a Democratic concern. I have heard Republican Senators discuss exactly the same thing. So I think that is the basic problem; I do not know the answer to it. I wish I did.

I appreciate all of your testimony here. I do have a couple more questions, but that is really the basis of what we are talking about.

Mr. WEGMAN. Senator, could I add just another point in addition to the point you were just making?

Chairman GLENN. Certainly.

Mr. WEGMAN. I think there should be some concern about how cumbersome and bureaucratic the process has become. There is no question that is a political judgment. Regulatory decisions cannot be divorced from politics and officials who serve in high positions in any administration serve to further the interest of the President. I think that is natural. That is the way the process was intended to operate. But I do think that once a president nominates and selects an individual to head EPA or to head OSHA or to head the National Highway Traffic Safety Agency and his administration and sends that individual up to the Congress and the Senate confirms that individual for that position, that except for those major decisions that receive a higher level of review, the designated official ought to be left free to fulfill has statutory mandate.

There are plenty of opportunities through the normal course of events to review the way the regulatory official carries out his mission; the President can do so through the annual budget process, and Congress can do so by exercising its oversight functions, and through its appropriation and authorizing Committees.

My concern is that this additional layer of bureaucracy has been imposed through the 12291 and 12498 process on such a regular basis, and affects virtually every significant decision that comes along. I think that is undesirable, and apart from the other questions that have been talked about, it creates excessive bureaucracy and there is no question that it adds to delay.

Chairman GLENN. I can turn my hat right around, though, and say that as far as the ideology goes, we elect a president and a new administration to carry out a certain ideological platform for Government, if you will, and so perhaps they are doing some of that through the OMB process. The question is, to what extent should this be permitted? Should it go to the extent that it does now?

Ms. CLAYBROOK. But do not you think that the cabinet secretary and the agency head, both of whom are selected by the President, supposedly in consonance with his philosophy or her philosophy and that are approved by the Senate—don't you think that they really should be the ones who carry out the President's policy, and if they do not they should be fired? And that is what happens.

Chairman GLENN. Well, where do you coordinate? Also Cabinet Secretaries ability to carry out their functions are determined to a very major extent—if not complete extent—by the budget they get.

Ms. CLAYBROOK. That's correct.

Chairman GLENN. Now, somebody has to coordinate that budget. We are not proposing to replace all of OMB, nor would we propose that. Where else do you coordinate things? Every department head is going to be out shooting as hard as he can to get his budget. You can bet on that. And if everyone got their own wish list on the budget, we would be even in more trouble than we are with $1.4 trillion being added to the debt in the last 8 years.

So how do you coordinate such things and make sure there is somebody that balances the budget? There has to be some head-knocking some place. Everybody cannot have everything they want in every department.

What OMB must coordinate is all the mandates, the rules, the regulations that determine what the budget is going to be. I guess I do not really question the fact that OMB should be the coordinator, but I do question how that function is being carried out.

Ms. CLAYBROOK. Well, I think they should coordinate the budget, and that is where they have expertise with numbers to do that. But on the issue of substantive regulations, it seems to me that if there is a White House review group, whether it is out of OMB or whether it is a separate one, as in the case of the Carter Administration, that that review group looks at the most important, significant ones and secondly, that they do not make the decision.

They can raise a fuss. If OMB raises a fuss, Senator that fuss spreads throughout the Government and everybody knows it, but why should not it be done on the public record?

Chairman GLENN. Let me take the pendulum over in the other direction. I am sure you would not say that every secretary should get every budget item he wants every year.

Ms. CLAYBROOK. But I am not talking about the budget. I am talking about regulations as opposed to the budget.

Chairman GLENN. But those regulations, though, are what determine much of his budget and the budget determines what regulations he is going to carry out. His budget determines what he is going to be able to do.

Ms. CLAYBROOK. That is right, but we have always acknowledged that OMB should have the final authority and be the decision maker, the final decision maker on budget. But as to how that budget is implemented and how it is carried out in great detail, I do not think that this works. I think it has been shown in this Administration that it doesn't and that it——

Chairman **Glenn**. I am not sure I understand, I do not want to get into a lengthy discussion here because we have other witnesses yet to come, but how could you possibly say that we are not discussing the budget, and yet you are saying the secretary is going to carry out all those rules and regulations which cost money? You have to coordinate some place.

Ms. **Claybrook**. Well, until 1981 OMB had only authority to control budget and it did a very effective job of it. Now it has added a second authority which is to review and decide whether or not we should have passive restraints in cars, whether or not Reye's syndrome ought to be noted on bottles of aspirin and the labeling of aspirin.

Those are not the kinds of decisions that cost the Government a lot of money. They cost industry some money, but not the Government, and they are not the kind of decisions OMB is qualified to make, I do not think.

Mr. **Vladeck**. And if you look at the history in the last 8 years of how OMB has fared when it has in fact displaced an agency's decisional authority, it has a very poor record.

If you look at what happened to the ethylene oxide standard when OMB required a portion of it deleted, the court set it aside. If you look at what happened to the hazard communication standard, after it was rewritten by OMB, the court set it aside. If you look at what happened to the formaldehyde standard, after OMB insisted that it be delayed and so forth, the court ordered the agency to expedite the rulemaking. If we look at the asbestos standard that was issued after OMB ordered a substantial portion of it deleted, the court set it aside. These decisions were made by judges that are appointed by Reagan.

Chairman **Glenn**. Okay, I agree with you if you mean regulations in which there is no budgetary cost and which determine what is carcinogenic and what is not, and so on. In fact, I think one of the areas that I disagree most with the way OMB has operated is their second-guessing of the scientists and the experts in the departments when OMB has very little expertise on their own unless they go out and commission a study.

Mr. **Vladeck**. Even if they got some separate study Senator, one of the astonishing things that came to light today, I litigated the ethylene oxide case for 7 years. Mr. Viscusi in his testimony today suggested that he prepared an analysis for the Office of Management and Budget.

Mr. **Viscusi**. That was done for OSHA.

Mr. **Vladeck**. For OSHA. That was not part of the public record, or the OMB analysis. It was never a part of the public record. To this day we really have no idea what motivated OMB to delete a portion of the standard. There is no reason why that debate took place in secret.

Chairman **Glenn**. Well, that is an area that I have been critical of OMB, too—where there was no money involved, where it was not a matter of coordinating the dollars that had to be spent on something, but where they took a different tack than expert agencies on some safety standard, on some carcinogenic material, perhaps, like formaldehyde. Maybe there is a reason that they can give us later on in their testimony for that. I would be glad to hear it, if they have one.

We are going to have to move on here, and I appreciate your being with us this afternoon, all of you. We may want you to answer some additional questions. If we submit them to you, we would appreciate a prompt reply so they could be included in the Comittee record.

Thank you all for being here this afternoon.

Our next panel is the Honorable James C. Miller III, Director of the Office of Management and Budget, and the Honorable S. Jay Plager, Administrator, Office of Information and Regulatory Policy, Office of Management and Budget.

Mr. Miller is not here yet but we had a short statement from him and we will enter it in the record. We understand that he may be here for a little bit of the hearing later on; is that correct?

## TESTIMONY OF JAY PLAGER, ADMINISTRATOR, OFFICE OF INFORMATION AND REGULATORY POLICY, OFFICE OF MANAGEMENT AND BUDGET[1]

Mr. PLAGER. Not quite, sir. Frankly, I thought that we understood that we were to be the first panel and Mr. Miller scheduled his day around that. He has been here but he had to leave for other commitments.

Chairman GLENN. What was the understanding, then? That you would be the first——

Mr. PLAGER. That we would be the first panel beginning at 2 o'clock, and apparently that was changed at the last minute as near as we can tell.

Chairman GLENN. Well, if that was the understanding, it was never my understanding, and the staff tells me here that that was not theirs, so perhaps there was some misunderstanding in communications.

Mr. PLAGER. Yes, sir, but he was here and he regrets that he had to go.

Chairman GLENN. Well, I am sorry I did not know he was here because I would have been quite happy to put him on earlier. Was he here in the room? I did not see him come in.

Mr. PLAGER. He was waiting out in the hall for awhile and then he left.

Chairman GLENN. Well, I wish somebody had let me know that because I would have tried to accommodate him.

Senator Roth's staff told us that if we could get him on by 3:15 he would appear personally. That is what the staff tells me.

Well, I am sorry I did not know he was out there because we could have altered the sequence of events here in the hearing, but we look forward to your testimony anyway.

Mr. PLAGER. Yes, sir. My name is Jay Plager. I am Administrator of the Office of Information and Regulatory Affairs, occasionally referred to as Darth Vader with you. At the moment I am feeling a little bit like the sacrifical lamb at this hearing. I will, however——

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[1] See p. 412 for Mr. Plager's prepared statement.

Chairman **Glenn**. No, I do not look at you that way at all. We are trying to get some information here that we can use and you have had some experience in this area. We have had some disagreements on some of the way things have been handled, but we are glad to discuss them here and hope we come to a mutually satisfactory conclusion.

Mr. **Plager**. Thank you, Mr. Chairman. I hope so. I will certainly work toward that end.

I submitted to you, sir, a lengthy statement and rather than read it to you, let me just ask you to put it in the record.

Chairman **Glenn**. Your entire statement will be included in the record.

Mr. **Plager**. I will make a brief opening statement and then be prepared to answer any questions you may have.

I appreciate the opportunity, Mr. Chairman, to meet with you today. You invited us to testify on the impact of Executive Order Number 12498. More specifically, you asked us to discuss the role of the Office of Management and Budget in the exeuctive regulatory review process and to describe how the President shapes the priorities of the wide array of regulatory agencies.

Executive Order 12498 commits the Administration annually to develop and then publish the Regulatory Program of the United States Government. We have just released the most recent edition, the 1988 Regulatory Program. This edition includes in Part 1 of the volume an overview of our experience over the past 7½ years, providing the Congress and the public a summary of other efforts at executive regulatory oversight.

This overview addresses many of the issues that you raised in our invitation and for that reason I ask your permission now to include a copy of part one of the 1988 Regulatory Program in the record of this hearing.[1]

Chairman **Glenn**. It will be included.

Mr. **Plager**. Thank you, sir. In my opening remarks I will summarize the structure and process of President Reagan's regulatory review program and I will describe what we have done to establish— Presidential oversight of Federal regulation as a way of governmental life. By 1988 the American public faced a complex, inefficient and constantly expanded system of Federal regulation. Millions of hours of private time and effort were spent complying with Federal reporting and recordkeeping requirements. It was not at all unusual for different agency rules and data collection requirements to cut across the same activities, creating overlap, conflict and duplication.

When President Reagan campaigned in 1980 he spoke out against this problem of excessive over-regulation. Once elected, the President moved quickly. He established the President's Task Force on Regulatory Relief, chaired by Vice President George Bush, and to oversee the growth of new regulations, President Reagan signed Executive Order Number 12291. Today that is the centerpiece of executive regulatory oversight activities. I might add that the Congress also made a major contribution at that time through the passage of the Paperwork Reduction Act of 1980.

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[1] See p. 653.

The results of this process of executive regulatory oversight have been dramatic. The number of new rules has dropped. The percentage of rules that reviewed regulatory burdens has increased. Compared to 1980, the number of pages devoted to the issurance of final regulations in the Federal Register in 1987 dropped by 35 percent.

However, by 1985 it became obvious that more could be done to improve the Federal regulatory system. Despite OMB review of agency draft regulations, and despite the mammoth expenditures Federal regulations exacted from some and the benefit they gave to others, Federal regulations were still being managed far less systematically than we managed direct Government spending. There was no established mechanism for tracking regulations through their often lengthy history to insure that the President and his agency heads were managing the development of these initiatives. As a result, President Reagan decided he needed to involve agency heads, policy officials, and the public earlier in the rulemaking process.

On June 4, 1985, he issued Executive Order Number 12498, Regulatory Planning Process, "In order to see that the laws are faithfully executed and that the policies of this Administration are reflected in the regulations issued under these laws."

The Executive Order obligates the Administration to publish every year a Regulatory Program. We published regulatory programs for 1985, 1986, 1987 and, as noted, just recently for 1988.

The concept and structure of regulatory planning is basically simple. All the significant regulatory actions that an agency has underway, including the regulatory development projects, should first be submitted to the agency head before going any further. Those that the agency head thinks are warranted then go to the President, acting through OMB, for review prior to being published in the annual Regulatory Program.

OMB performs this executive regulatory planning in a manner similar to the President's budget process. At the beginning of each year major regulatory agency drafts a summary of its regulatory policies and describes specific regulatory projects underway, including final rules, proposed rules and pre-rulemaking. OMB then reviews each agency's draft Regulatory Program for consistency with the Administration's regulatory policies and priorities, and the draft regulatory programs of other agencies.

OMB will also identify further regulatory or deregulatory actions that are necessary to achieve consistency with Administration policy. If OMB and the agency cannot resolve a policy dispute, it is referred to an appropriate forum in the White House and, when necessary, to the President himself.

Following this executive review, the Administration publishes its decisions in the Regulatory Program. We published the 1988 Regulatory Program this September. Part 1, as I have said, discusses the underlying law and policy that supports the Administration's coordination and review of Federal rulemaking. It also covers such topics as the weaknesses within the Federal regulatory structure, mechanisms for assuring agency adherence to the President's regulatory principles, regulatory policy guidelines, federalism and the role of economic analysis in the development of regulations.

Part 2 provides details on the 451 significant regulatory actions of 22 departments and agencies selected because of their economic importance, their policy precedent and other substantial effect. The Department of Health and Human Services, Labor, and Transportation, and the Environmental Protection Agency account for 60 percent of these actions. For 57 percent of the actions, agencies anticipate issuing a proposed rule within the planning year; 31 percent of the actions will be final rules that agencies anticipate will be issued during the year and 12 percent of the actions are at the early pre-rulemaking stage.

The 1988 Regulatory Program sets forth what each agency's objectives are, why the agency thinks it must do something at all, and what it is doing to insure the cost effectiveness of the alternatives that it does choose. Annual publication permits Congress and the American people to understand more fully the executive regulatory choices and it priorities, to understand more fully at the earlier stage, long before the publication of any proposed rule, how the executive intends to exercise the regulatory discretion that Congress has provided it by statute.

An important purposes of the regulatory planning process is to make the agency head personally involved in regulatory policy making at an early point in the agency's rulemaking process. As President Reagan stated in issuing Executive Order 12498, each agency head became, "accountable for the management of the regulatory process to insure that policy options are not narrowed prematurely and that each significant regulatory proposal will be considered in relation to others."

I know, Mr. Chairman, that you have several questions in mind, as indicated in your letter of invitation, and there may be others. Let me end my formal remarks by thanking you for the opportunity to appear—despite my opening comment—and the opportunity to discuss with you the regulatory process. I believe this is one of the most important activities our Government engages in. I will be happy to answer any question if I am able.

Chairman GLENN. Thank you. I certainly agree with your last statement, that his is one of the most important aspects of Government. If fact, let me go beyond that, When we have had heads of OMB or the nominees for that position come before this Committee which they do for their confirmation hearing, I have said publicly then and I will repeat it now, I do not think the Vice President is the number 2 man in Government. The number 2 man in terms of effectiveness of Government is the Director of OMB, because that person is the one who does more to really determine what the direction of Government is going to be.

I think presidential candidates should make known their head of OMB—if we really wanted to know what the bent of Government is likely to be.

Just to set the record straight, before I ask any further questions with regard to Mr. Miller's departure, Mr. Miller's advance man, Ivan Ransifer, called at 1:15 this afternoon and spoke with our staff here. The chief clerk, Mickey Prosser, went over the witness list and the order of appearance with him. So I am sorry if there was any misunderstanding, but I do not think the fault was on our part.

You make the point that OMB cannot exercise veto power over the agencies because the agency heads can always take their case to the President or an appropriate forum within the White House.

Do you have any examples in which an agency head has appealed a disagreement with OMB over a 12498 submission?

Mr. **Plager**. Not in my time, Mr. Chairman, although admittedly my time has been relatively short. I do not know of my personal knowledge of any recent examples that have happened. I would not be surprised if in earlier years that may have occurred, and there may have been the need to iron out what it was that the Administration's regulatory policy really meant, because at some point all of those things were in development.

I think to understand the context in which that issue arises, we have to look—just at the moment—at the process again. The process actually is an interactive process between the agency and the President's Executive Office, the OMB, in the sense that even before a draft Regulatory Program is formally submitted for review, the agency and the Executive Office of the President in the White House are engaged in discussion about overall Administration policy, regulatory policy, things that need to be done. It would probably be a most unusual circumstance in which those issues would not get worked out and resolved.

Chairman **Glenn**. Well, most of these regulations are being carried out pursuant to laws passed here in the Congress and signed by the President. It is not just an issue with the White House; that is the bone of contention we have here.

The agencies are quite religiously trying to carry out their mandate, as they see it, under the law, and yet they have to go to somebody else to get approval on what they say Congress intended.

Is there any instance that you know of in which an agency promulgated a regulation over OMB's objection?

Mr. **Plager**. Yes, sir.

Chairman **Glenn**. Like what?

Mr. **Plager**. Just recently the Secretary of Agriculture promulgated a notice of proposed rulemaking that would have the effect of removing an existing requirement for correct labeling or proper labeling of sausage meat and other types of manufactured meat which contains what is called mechanically separated meat. Under the existing regulation, the manufacturer of such a product has to indicate that this mechanically separated meat is part of the product. This omission sounds rather relatively harmless, but in fact, however, there remains a considerable amount of crushed material in the meat itself.

The Secretary of Agriculture recently submitted to OMB a proposal to remove that labeling requirement. We returned it for reconsideration on the grounds that it was not consistent with the President's overall Regulatory Program, that its labeling was warranted, it was an ingredient that people should know about, and that there was no clear showing that the net benefit to society would be greater than the cost by disguising the fact that this material was in the meat. The Secretary of Agriculture chose instead to go ahead and publish that regulation despite the fact that we sent it back and asked that he rethink it.

So there are occasional examples of that.

Chairman GLENN. Do you have any other examples?

Mr. PLAGER. Well, we try not to have that happen very often, Mr. Chairman.

Chairman GLENN. I realize that.

Mr. PLAGER. Offhand, I cannot cite you any others at the moment.

Chairman GLENN. Where there is a law that has to be carried out that is of a scientific nature or involves health or safety matters, there are scientists in the agencies or other branches of Government that recommend how to carry out the mandate of Congress. Maybe it is going to cost something, and you question their decision at OMB.

How, then, do you go about second-guessing someone who has scientific expertise in an area? How does OMB go about saying, "no, you are not right," or "it is not as important as you say it is," or whatever?

Mr. PLAGER. Well, I am very glad you asked that question. I would suggest that it is not that we second guess. What we do is we ask the agency to produce the evidence that supports the agency's proposal. My staff is quite small, and while highly professional, cannot even begin to duplicate the extensive staffs that the agency has, and therefore, we rely very heavily on the technical expertise of the agency. What we do not rely on is necessarily the agency's conclusions as to what that technical expertise reveals, and if we add the sums up that they produce for us and it looks like their addition is bad—and I am not now just talking dollars, I am speaking figuratively—we then go back to the agency and we say, hey guys, you have the data, you have the expertise, but you came to a conclusion that does not seem to make sense, does not seem to add up in the light of all of the studies that you yourselves produced or are referring to; would you look again at it.

Chairman GLENN. But who do you have that has that kind of expertise in science, say, that says, "hey, you guys, this does not look like the right decision?"

Mr. PLAGER. Well, that is not really a matter of scientific expertise at that point. That is a matter of sound judgment as to what makes sense in the light of all of the facts.

Chairman GLENN. Well, let me give you one example. I mentioned this in my opening statement. I do not know whether you were here then or not, but the Labor Committee had a hearing on OSHA. I alluded to it in my opening statement. There were some scientists at OSHA who suggested a standard for formaldehyde, and OMB's desk officer, who was an economist by training, took issue with the agency's cancer risk assessment, its valuation of various epidemiological studies.

Now, that is hardly a science expert questioning what OSHA had recommended.

Mr. PLAGER. I think the desk officer in that case pointed to the fact that there were more studies in the record that indicated that formaldehyde was not a carcinogenic ingredient than there were studies that said it was. Everyone agreed that formaldehyde is an irritant of various kinds. A substantial body of material in the record indicated that there was no evidence that it was a carcinogen.

Chairman GLENN. Well, that is not my understanding. It seems to me that the experts over the OSHA office have access to all of these different studies, too. You always can find a study around Washington from somebody that says something isn't right if you have some preconceived idea, an ideological position, or if you do not want to interfere with industry or certain producers or manufacturers. That is what bothers me most about this—what we have seen in some of these areas in the past. We see some decisions being made that are not made strictly on a scientific basis.

Mr. PLAGER. As I see our responsibility under both the statute and under the executive orders, Mr. Chairman, our job is not to make decisions on the basis of the record. That is for the agency to do.

Chairman GLENN. That is right. I have a little difficulty understanding how your economist determined what was good and bad and which studies were good and which were not in order to make a decision against them. How did he know that?

Mr. PLAGER. With all due respect, sir, I do not think he made that decision. First of all, he has no authority to make that kind of decision. And secondly, I do not think that was what he was saying.

I think what he was saying to the agency, with our approval, was that the agency's evidence is very conflicting; the evidence in the record is very conflicting; why does the agency conclude on the basis of conflicting evidence that A is right rather than B; what leads the agency to that conclusion? I think it is a perfectly fair question.

One of the things—I think from the dialogue you were having with the panel before this—clearly comes into view, Mr. Chairman—if I may just offer this thought—is that there is a kind of assumption that the people in the agencies have an objective, scientific basis for doing everything they do and somewhere over there in that big building on Pennsylvania Avenue are people who decide things only on the basis of politics.

I think that is a terribly distorted view of the way in which the Government operates. Most of these agencies, in fact, are headed by—if not all of them—by political appointees who share to some extent—lesser or greater extent—the basic approaches of this Administration, and many of the people in these agencies in the lower ranks of the agencies are not people who ought to be deciding policy. They ought to be producing information. They ought to be doing studies. They should be making recommendations. But they ought not to be setting the policy of the United States Government. That is why the President gets elected and that is why under our system he gets to appoint policy decision-makers in the agencies and in the White House.

Chairman GLENN. Okay. I agree with you only up to a certain point and then I take violent exception with your statement. The President does not operate alone in our system. The President is not a Prime Minister. The President does not have the power of a Prime Minister.

The President does not speak with final authority for this Government. That is a shared responsibility under our Constitution—and I will not launch into a Constitutional lecture here, because I am not a lawyer nor a constitutional scholar—but those powers are shared with the Congress. We represent this Government as well as the President does, the many hundreds of us here on Capitol Hill. Our activities, once passed and signed into law, are to be executed. Executed by the Executive Branch of Government. When we push legislation containing certain standards, we expect that they will be carried out. When we begin to see departures from that, then we have to blow the whistle. That is in effect what we are doing today.

Mr. **Plager**. Yes, sir.

Chairman **Glenn**. And we oversee OMB, which we helped form. We put the regulatory process under OMB by our activity here. The President did not do that. We did, and we wanted to see that regulatory activity was coordinated so as to cut our duplication, to make sure there was monetary consideration. We do not expect a president to go off—even though he was elected with certain mandates—to go off and violate or bypass certain requirements of law, whether through OSHA or wherever else. It is up to him to carry those mandates out.

Now, if an agency head has a budgetary problem, and he comes to OMB, and he says, I just do not have the money to do both. He says, with the budget restrictions under which we are operating, I have to make a value judgment and here is one area I can push on, here is another I cannot. He says, Congress, I am sorry, you do not have enough money over here to do both. And he and OMB make the judgment. That is how the system is supposed to work and that is the reason we put it under OMB—so those judgments could be made.

Now, the question before us, as I have said before, is are we adhering to that fine line between legislative requirements and the promulgation of the ideological views the President was elected to carry out. We feel here that the pendulum has swung too far over onto the ideological side. the President has expressed a "new federalism" he has put that into effect. We have had a regulatory reform program Government-wide regulatory reform program—go into effect which deregulated airlines and other industries. We have been in a very turbulent period as far as regulatory reform goes.

So that is the issue here. How far do we go with this?

Mr. **Plager**. You and I have absolutely no quarrel, Mr. Chairman. I agree entirely with everything you said. I have no problem with your statement about this being a shared Government and the roll of the Congress. And indeed, in these executive orders you will invariably find the caveat that "to the extent permitted by law" these following criteria will be applied by the agencies.

There is no question in anybody's mind—certainly not in mine—that the Congress has the final say when it comes to setting forth a legislative mandate. To the extent that the Congress charges an executive agency with the exercise of discretion—and there are several ways for the agency to perform its duties—my own feeling in studying the Constitution is that the President owes an obligation to the Congress and to the people who elected the President to insure that the exercise of that administrative discretion is consistent with the Administration's program as well as with the Congressional mandates.

And so the effort that we try to engage in is to honor the Congress' will 100 percent. To the extent the Congress has given discretion to the Executive Branch, the agency head has the final decision to make. But the guidance and review process is to assist that agency head in understanding what the President's program is about because, after all, that agency head is the President's appointee.

Chairman GLENN. Okay. I do not want to argue this all afternoon, but it is not the President's program in most of these cases. It is not his program.

Mr. PLAGER. It is Congress' program.

Chairman GLENN. No. It is the people's program as passed by the Congress and signed by this or previous presidents. It is the law of the country, and the President is going to live up to the law and the intent of the law as well as the spirit of the law. I am not saying that he hasn't done that. But this is not a matter of the President's policies. Every time you say that, I cringe a bit because it is not an issue of the President's policy. When it is the law, it is the law. When we pass a law and a president has signed it, it is the law, and every President will execute that law as he takes the oath to do.

Mr. PLAGER. And I think the record is clear that this President has indeed followed the law.

Chairman GLENN. Well, I do not have any examples right before me here which say he did not. Let's just say I feel that in some of these areas—OSHA regulations and thinks like that—where there has been less than overall enthusiasm in the Administration for the particular policies, the Administration has let things slide more than some of us felt the law would like to see them slide. I guess that would put it in the right terms.

Mr. PLAGER. All right, sir.

Chairman GLENN. Since Executive Order 12498 has been issued, can you tell us how many proposed and final rules OMB has reviewed under the order? Do you have a figure for that?

Mr. PLAGER. Under 12498?

Chairman GLENN. Yes.

Mr. PLAGER. With your permission, I have here my Deputy and the branch chief who worries about these things. Let me ask them.

Chairman GLENN. Secretary Miller had in his statement that by October first of this year, OIRA had completed a review of over 20,000 draft agency regulations, over 500 of which were considered as major in economic or social impact.

Mr. PLAGER. I think that refers to 12291 procedures, sir, rather than 12498.

Chairman GLENN. Okay.

Mr. PLAGER. I think under 12498 we have about 2,000 items. Many of them, however, carry forward from year to year so that it is not 2,000 new ones every year.

Chairman GLENN. What percentage of those would you estimate were found to be consistent with the Administration's program when the initial drafts were sent in by the agencies? Can you give us an estimate on that?

Mr. PLAGER. I would say the overwhelming majority, sir.

Chairman GLENN. How many of these were modified by the agencies after OMB's review at your suggestion?

Mr. PLAGER. I doubt that we have specific data. Again, Mr. Chairman, the process is an iterative one, that is, there are discussions going back and forth. To some extent it is editorial and formatting and we might say to an agency, we do not understand the third sentence in your fourth paragraph, what do you mean? And they will look at it and they will say, I see what you mean, it is not very clear, we will rewrite it.

Now, I do not know whether you want to count that, and if you want to count it, I do not know how you could count it. I think what you are asking is—have some substantial number of agency proposals for rulemaking been thwarted by OMB based on serious policy disputes. If that is the question, the answer is very few, to my knowledge. That is simply not the way the process works out.

Chairman GLENN. Well, our view here when OMB was set up is that OMB's intervention should be the exception rather than the rule.

Mr. PLAGER. Absolutely.

Chairman GLENN. And intervene only when there were very significant regulatory issues at stake. Those were the concepts underlying 12498. We want to see OMB eliminate duplication, improve coordination, not to duplicate an agency's work or to act as a basic decision maker, especially on scientific matters in which OMB has little or not expertise.

Mr. PLAGER. I could not agree more with you, Mr. Chairman, and we do not engage in that activity.

Chairman GLENN. How do you operate, then, to keep OMB as an arbiter and a coordinator as opposed to an agency that is changing or cutting back on regulations?

Mr. PLAGER. Well, how do we operate? I am not clear whether you are asking about 12498 particularly or whether you want to talk about the whole review process.

Chairman GLENN. 12498, basically.

Mr. PLAGER. Basically the way it works is an agency comes forward with its ideas. It talks to one of my desk officers. My desk officers discuss it in the light of what has been done in the past and where we are and what is going on. They have discussions back and forth. If there are serious questions to be dealt with, they get escalated to my deputy and his counterpart in the agency. If that does not work out, I hold meetings. I am having one this afternoon on a question in which there are several agencies who are having a dispute.

Let me make one point, if I may, Mr. Chairman. Oftentimes the issue is not just an issue between OMB and an agency. Oftentimes the issues are between agencies. When one agency proposes to do something, our job is to make sure that other agencies affected by that action know about it, and they get into a fight.

Chairman GLENN. That is one of your major functions, to be the arbiter.

Mr. GLAGER. Absolutely.

Chairman GLENN. That is what we agreed with.

Mr. PLAGER. And that is what I spend my time on. I really think so much of this constant hammering about a few cases that are held up—and I am not here to defend them or to attack them—but the constant hammering on a few cases distorts the major picture of what is going on out there. What is going on out there day in and day out is a slogging through an enormous amount of paper and detail trying to insure that there is some reasonable consistency in the way the Federal Government behaves in implementing the Congress' will.

Chairman GLENN. Do we need some changes to 12498? Let me give you an example.

Mr. PLAGER. All right, sir.

Chairman GLENN. Executive Order 12498 does not cover the independent agencies. For example, while the FTC and the Antitrust Division of the Department of Justice both handle antitrust and regulatory issues, the FTC is not covered by the Order and the Antitrust Division is.

Does the fact that order 12498 coverage is circumscribed in this way undermine its effectiveness for interagency coordination?

Mr. PLAGER. I do not think it undermines its effectiveness. I think it could be broadened to include all of the agencies. I personally would think that it would be in the Government's interest and the Congress' interest to have somebody in a position to oversee the entire executive regulatory behavior, including the independent agencies.

Chairman GLENN. It might be, and I am of mixed mind on this. I can turn my hat around and argue right along with you on it. On the other hand, we formed the independent agencies so they would be immune from the politics of one administration or another. So we are on the horns of a dilemma as to how much we want them to be independent and how much we might want them to come under the coordination efforts of OMB. That is something we may have to resolve ourselves.

Mr. PLAGER. I understand.

Chairman GLENN. Do we really need 12498 if it is working the way you say it is? You testified that there is very little change made, if any, in the regulations that come before OMB or OIRA. If there is no modification made to agency submissions under Executive Order 12498, what purpose does it really serve in practice?

Mr. PLAGER. Well, I am glad you asked that, Mr. Chairman, because I think there is a general misunderstanding of the true impact of 12498. The impact of 12498 is not to give OMB a review authority. The impact of 12498 is to make the agency head responsible for the activity of his or her agency. One of the things that was clearly going on and indeed to some extent still continues is that these enormous regulations agencies are grinding out regulations almost mindlessly, each program pushing its own program, each sub-unit pushing its own activities. The agency heads by and large were not attentive and did not appreciate the impact of that enormous flow of regulatory activity.

One of the things that 12498 has done is to have the President say to his agency heads, by golly, you people have to get control of what your agencies are doing. And basically what we do is coordinate that effort. We do not sit there in judgment on them.

Chairman GLENN. I have no more questions. I am appreciative that you were here this afternoon. Thank you very much for your testimony.

I would just close by saying that this is a continuing issue that the Committee will be looking at, and I say this quite apart from politics or from Bush, Dukakis, Reagan or anybody else. The Committee has been very concerned that the OMB function be kept to coordination and arbitration of disputes on overlapping jurisdictions which creep into some of the legislation that goes out of here. We are very concerned that regulation have a point of coordination and that that be OMB. But the ideological concerns that a particular president or administration may have should not overcome the major objectives of laws passed by Congress. Can we not wind up with OMB being an ideological organization in pursuit of certain goals which the President may not be able to get through the Congress.

So we are going to be continuing our oversight of OMB, whoever the new president, whatever the new administration may be in the new year. And we will undoubtedly have more hearings next year.

I think, also, just as a general statement, we certainly should review this issue more often than once every 12 or 13 years. As I said, the last time we did anything like this was in 1977. I had been on this Committee just a couple of years at that time. One of the actions we took at that time, which Ms. Claybrook objected to—I did not ask her a further question about this—was the sunsetting of some of these commissions, boards, councils, and other information developing groups in Government.

One of the problems we had when I first came on this Committee was we found some 1,600 boards, commissions, councils, and groups, of all kinds and shapes; some of them had been on the books for many, many years, serving very little purpose. After looking at these things over a couple of years, we were able to eliminate, as you recall, somewhere around 400 of those councils that weren't doing any good but spending a lot of money—people who had a couple of meetings a year, floated back and forth across this country for little real purpose, and spent a lot of money doing it.

We eliminated many of those. And at that time, to prevent this thing from growing back out of control again, we put some sunset legislation in—legislation that said that councils formed were to perform their duty and if they were worthy of being reauthorized again, we would take them up and reauthorize them. If not, they sunset.

I did not get back to Ms. Claybrook on this topic because of our limited questioning period here, but that is what we were faced with at the time. I know more information needs to be developed in some of these areas. I do not want to prevent that information from being developed.

On the other hand, I do not want to see this whole Government growing out of control again, either.

Mr. PLAGER. Exactly.

Chairman GLENN. So we share that goal.

Mr. **Plager**. Mr. Chairman, if I could just make one point, which is that my personal belief is that whoever the President is, and regardless of any given President's ideology, that president will find that if he or she wants to manage the Government effectively and carry out the Congress' will, he or she has got to have some kind of a coordinating, review mechanism equivalent to what we now have. They may change the name. They may fiddle with the design. But my own view is that we may not like the individual decisions in any given case but the overall management of the Executive Branch and the ability to carry out the Congressional legislation depends on having some kind of central coordinative review mechanism.

I am delighted to have had the opportunity to come to this hearing.

Chairman **Glenn**. Thank you. And I do not disagree with you at all on that. I share a concern that things be done at one spot so we can coordinate them best. The problem is if that one spot gets a little over exuberant with regard to ideology and not just carrying out the mandate of law, then we are duty-bound at this end of the avenue—whoever is in the White House—to bring that up and talk about it a little bit and see if we cannot correct it.

Thank you very much, the hearing will stand in recess subject to the call of the chair.

[Whereupon, at 4 p.m., the hearing was recessed subject to the call of the Chair.]

II

# APPENDIX

100TH CONGRESS
1ST SESSION

# S. 1504

To provide for an alternative to the present adversarial rule making procedure by establishing a process to facilitate the formation of negotiated rule making committees.

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IN THE SENATE OF THE UNITED STATES

JULY 17 (legislative day, JUNE 23), 1987

Mr. LEVIN (for himself, Mr. COHEN, Mr. GRASSLEY, and Mr. RIEGLE) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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# A BILL

To provide for an alternative to the present adversarial rule making procedure by establishing a process to facilitate the formation of negotiated rule making committees.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Negotiated Rule Making Act of 1987".

## FINDINGS

SEC. 2. The Congress finds that:

(1) Government regulation has increased substantially since the enactment of the Administrative Procedure Act.

(2) Although the purpose of regulation has been to promote the safety and general welfare of the American public, the rule making process tends to discourage parties from meeting and communicating with each other, and this leads to the assumption by parties with different interests of conflicting and antagonistic positions toward agency rules, which may result in expensive and time consuming litigation.

(3) The adversarial nature of rule making deprives the affected parties and the public at large from the benefits of face-to-face negotiations and cooperation in developing and reaching agreement on a rule.

(4) The adversarial nature of rule making also deprives the affected parties and the public from the benefits of shared information, knowledge, expertise, and technical abilities possessed by the affected parties.

(5) A proposed rule developed and negotiated by the parties who are affected by the rule will increase the acceptability and enforceability of the rule by those parties, and affected interests will be less likely to resist enforcement or challenge the rule in court.

(6) Although many agencies already have the authority to establish negotiated rule making committees pursuant to the laws authorizing such agencies and their programs and pursuant to the Federal Advisory

Committee Act, and, in fact, several agencies have already successfully engaged in negotiated rule making in connection with informal rule making proceedings, the process has not been widely employed by other agencies, perhaps because such agencies are unfamiliar with the process or uncertain as to their authority. This Act will establish a framework for the conduct of negotiated rule making and will encourage agencies to use the process whenever it will enhance the informal rule making process.

### PURPOSE

SEC. 3. The purpose of this Act is to authorize agencies to supplement and enhance the rule making procedures under the Administrative Procedure Act, where appropriate, by establishing a negotiated rule making committee of persons representing interests that will be affected by an agency rule to participate in and negotiate that rule's development.

### DEFINITIONS

SEC. 4. For the purpose of this Act:

(1) The term "agency" has the same meaning as in section 551(1) of title 5, United States Code.

(2) The term "person" has the same meaning as in section 551(2) of such title.

(3) The term "party" has the same meaning as in section 551(3) of such title.

(4) The term "rule" has the same meaning as in section 551(4) of such title.

(5) The term "rule making" has the same meaning as in section 551(5) of such title.

(6) The term "convenor" means an individual selected by an agency to assist the agency in determining whether a negotiated rule making procedure is feasible and appropriate.

(7) The term "consensus" means unanimous agreement among the interests represented in the development and negotiation of a proposed rule under this Act, unless a negotiated rule making committee defines such term to mean a general but not unanimous agreement.

(8) The term "interest" means, with respect to an issue or matter, multiple parties which have a similar point of view or which are likely to be affected in a similar manner.

(9) The term "mediator" means a person who aids in the discussions and negotiations among the members of a negotiated rule making committee to develop and negotiate a proposed rule.

(10) The term "negotiated rule making committee" means an advisory committee established by an agency in accordance with this Act and the Federal

Advisory Committee Act to consider and discuss issues for the purpose of reaching a consensus in the development of a proposed rule.

DETERMINATION OF NEED FOR NEGOTIATED RULE MAKING COMMITTEE

SEC. 5. (a) An agency may establish a negotiated rule making committee to develop and negotiate a proposed agency rule whenever the head of the agency determines that the use of the negotiated rule making procedure is in the public interest. In making such a determination, the head of the agency shall consider whether—

(1) there is a need for a rule;

(2) there are a limited number of identifiable interests that will be significantly affected by the rule;

(3) there is a reasonable likelihood that the rule can be developed by a negotiated rule making committee composed of persons who can adequately represent the interests identified pursuant to paragraph (2), and who are willing to negotiate in good faith to reach a consensus on the proposed rule;

(4) there is a reasonable likelihood that the negotiated rule making committee will reach a consensus on the proposed rule within a fixed period of time;

(5) the negotiated rule making procedure will not unreasonably delay the notice of proposed rule making and the issuance of the final rule;

(6) the negotiated rule making procedure will not unreasonably increase agency expenditures to develop the final rule; and

(7) the agency, to the maximum extent possible, will use the consensus of the negotiated rule making committee with respect to the proposed rule as the basis for the rule proposed by the agency for notice and comment.

(b) An agency may use the services of a convenor to assist the agency in (1) identifying parties that may be significantly affected by a proposed rule and (2) conducting discussions with such parties to identify the issues of concern to such parties and to ascertain the feasibility and desirability of the establishment of a negotiated rule making committee by the agency. The convenor shall report its findings and shall make recommendations to the agency for the consideration of the agency. The convenor shall recommend, upon request of the agency, the names of persons who are qualified to represent the significant interests affected by the proposed rule.

### PUBLICATION OF NOTICE

SEC. 6. (a) If, after considering a convenor's report or after conducting its own assessment, an agency decides to establish a negotiated rule making committee to develop and negotiate a proposed rule, the agency shall publish in the Federal Register a notice which shall include—

(1) an announcement that the agency intends to establish a negotiated rule making committee to develop and negotiate a proposed rule;

(2) a description of the subject and scope of the rule to be developed, and the issues to be considered;

(3) a list of interests which are likely to be significantly affected by the rule;

(4) a list of persons proposed to represent these interests;

(5) a proposed set of committee procedures for review and adoption by the negotiated rule making committee;

(6) a proposed agenda and schedule for completing the work of the negotiated rule making committee;

(7) a description of administrative and support services for the negotiated rule making committee to be provided by the agency; and

(8) a solicitation for comments on the proposal to establish the negotiated rule making committee and on the proposed membership of the negotiated rule making committee.

(b) Persons who may be affected by a proposed rule and who believe that their interests will not be adequately represented by any person specified in a notice pursuant to paragraph (4) of subsection (a) may apply for, or nominate another person for, membership on the negotiated rule making committee to represent their interests with respect to the proposed rule. Each application or nomination shall include—

(1) the name of the person and a description of the interest such person will represent;

(2) a written commitment that the applicant or nominee will actively participate in good faith in the development of the rule under consideration, and evidence that the applicant is authorized to represent the interest the person proposes to represent; and

(3) an explanation of why the persons specified in the notice pursuant to subsection (a)(4) will not adequately represent the interests of the person submitting the application or nomination.

### ESTABLISHMENT OF NEGOTIATED RULE MAKING COMMITTEES

SEC. 7. (a) The agency shall provide at least 30 calendar days for the submission of comments and applications pursuant to section 6.

(b) After considering comments and applications submitted under section 6, if the agency determines that a negotiated rule making committee will represent the interests that will be significantly affected by a proposed rule and the persons representing such interests on such negotiated rule making committee are likely to reach a consensus on a proposed rule, the agency may establish a negotiated rule making committee as an advisory committee pursuant to section 9 of the Federal Advisory Committee Act. If the agency decides not to establish a negotiated rule making committee after considering such comments and applications, the agency shall promptly publish notice of that decision and the reasons therefor in the Federal Register.

(c) The agency shall limit membership on a negotiated rule making committee to 25 members unless the agency head determines that a greater number of members is necessary to the functioning of the negotiated rule making committee or to achieve balanced membership. Each negotiated rule making committee shall include at least one individual representing the agency.

### CONSIDERATION OF PROPOSALS AND CONDUCT OF NEGOTIATIONS

SEC. 8. (a) Each negotiated rule making committee established pursuant to this Act shall consider the matter proposed by the agency for consideration and shall attempt to reach a consensus concerning a proposed rule with respect to such matter and concerning any other matter the negotiated rule making committee agrees is relevant to the proposed rule.

(b) The official representing the agency on a negotiated rule making committee shall participate in the deliberations and activities of the negotiated rule making committee with the same rights and responsibilities as other members of the negotiated rule making committee. The agency official shall be authorized to fully represent the agency in the discussions and negotiations of the negotiated rule making committee.

(c) Notwithstanding section 10(e) of the Federal Advisory Committee Act, an agency may nominate either a person from the Federal Government or a person from outside the Federal Government to mediate the negotiations of the committee, subject to the approval by consensus of the negotiated rule making committee. If the negotiated rule making committee does not, for good reason, approve the agency's nominee of a mediator, the agency shall withdraw the nomination and submit a substitute nomination. If a negotiated rule making committee does not approve any nominee of the agency for a mediator, the negotiated rule making committee shall, with the concurrence of the agency, select a person to chair the committee. The agency official designated to represent the agency in substantive issues shall not chair the negotiated rule making committee or serve as mediator.

(d) A mediator approved or selected by a negotiated rule making committee shall—

(1) chair the meetings of the negotiated rule making committee in an impartial manner;

(2) assist the members of the negotiated rule making committee in conducting discussions and deliberations; and

(3) manage the keeping of minutes and records as required by subsections (b) and (c) of section 10 of the Federal Advisory Committee Act, except that any personal notes and materials of the mediator or of the members of a negotiated rule making committee shall not be subject to section 552 of title 5, United States Code.

(e) A mediator of a negotiated rule making committee shall act impartially and shall not vote on any agreement or recommendation made by the negotiated rule making committee.

(f) A negotiated rule making committee established pursuant to this Act shall adopt procedures for the operation of the negotiated rule making committee, including procedures with respect to membership, alternate members, disclosure of negotiation offers and statements, subcommittee and caucus procedures, and minutes and recordkeeping. A negotiated rule making committee may change its membership, rules, or agenda if the interests represented on the negotiated rule making committee reach a consensus on such change. The procedural rules set forth in section 553 of title 5, United

States Code, shall not be applicable to a negotiated rule making committee.

(g) At the conclusion of negotiations, a negotiated rule making committee shall prepare and transmit to the agency that established the negotiated rule making committee a final report and documents with respect to the negotiations conducted by the negotiated rule making committee, as may be required by the agency. If the negotiated rule making committee reaches a consensus and develops a proposed rule, the report shall contain the proposed rule and a concise statement of the basis and purpose of that rule. If the negotiated rule making committee does not reach a consensus on a proposed rule, the report shall specify the areas in which the negotiated rule making committee reached a consensus on a proposed rule and the areas of disagreement among the negotiated rule making committee, and shall include such recommendations and background materials as the negotiated rule making committee considers appropriate.

(h) In addition to the report specified by subsection (g), a negotiated rule making committee shall submit to the agency the records required by subsections (b) and (c) of section 10 of the Federal Advisory Committee Act.

### TERMINATION OF COMMITTEES

SEC. 9. (a) Except as provided in subsection (b), a negotiated rule making committee shall be terminated upon promulgation of the final rule under consideration, unless the agency specifies an alternate termination date.

(b) An agency may terminate a negotiated rule making committee at any time if the agency determines that the negotiated rule making committee is not making sufficient progress toward reaching a consensus on a proposed rule or if the agency determines there is no further need for the committee.

### EMPLOYMENT OF CONVENORS AND MEDIATORS

SEC. 10. (a)(1) An agency may employ or enter into contracts for the services of an individual or organization to serve as a convenor or mediator for a negotiated rule making committee under this Act, or may use the services of a government employee to act as a convenor or a mediator for a negotiated rule making committee.

(2) An agency shall determine whether a person selected to serve as a convenor or mediator of a negotiated rule making committee under paragraph (1) has any financial or employment interest that would preclude such person from serving in an impartial and independent manner.

(b) For purposes of this Act, an agency is authorized to utilize the services and facilities of other Federal agencies and public and private agencies and instrumentalities with the consent of such agencies and instrumentalities and with or without reimbursement to such agencies, and to accept voluntary and uncompensated services without regard to the provisions of section 1342 of title 31, United States Code.

COMPLIANCE WITH FEDERAL ADVISORY COMMITTEE ACT

SEC. 11. (a) Each agency establishing a negotiated rule making committee under this Act shall comply with the provisions of the Federal Advisory Committee Act with respect to such negotiated rule making committee, except that meetings of individuals for the purpose of considering and advising an agency on the feasibility of establishing a negotiated rule making committee shall not be subject to the requirement to charter an advisory committee specified in section 9(c) of the Federal Advisory Committee Act.

(b) Meetings of subgroups or caucuses of a negotiated rule making committee may be in closed session for the purpose of determining negotiating positions or for developing alternative proposals for consideration by the entire negotiated rule making committee in open session.

(c) Members of a negotiated rule making committee shall be responsible for their own expenses of participation in such negotiated rule making committee, except that an agency may agree, pursuant to section 7(d) of the Federal Advisory Committee Act, to pay reasonable travel and per diem expenses, and reasonable compensation, to persons affected by the rule if such persons certify that they do not have adequate financial resources to participate in such negotiated rule making committee and if the agency determines that their membership on the negotiated rule making committee is necessary to assure adequate representation of their interests.

### ROLE OF THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

SEC. 12. (a) An agency should consult with the Administrative Conference of the United States for information and administrative assistance in forming a negotiated rule making committee, and with the Administrative Conference of the United States and other public or private individuals or organizations for information and assistance relating to negotiation and mediation processes.

(b) The Administrative Conference of the United States, in consultation with the Federal Mediation and Conciliation Service, shall maintain a roster of individuals who are qualified to act as convenors or mediators in negotiated rule making proceedings. The roster shall include individuals both from government agencies and private groups, and shall be made available upon request. Agencies also may utilize rosters maintained by other public or private individuals or organizations.

(c) The Administrative Conference of the United States is authorized to enter into contracts for the services of mediators and convenors which may be used by government agencies, on an elective basis, in negotiated rule making proceedings. Payment for mediation or convenor services obtained pursuant to such a contract shall be made by the agency obtaining the services, unless the Chairman of the Administrative Conference agrees to pay for such services pursuant to subsection (f).

(d) The Administrative Conference of the United States shall compile and maintain data on negotiated rule making proceedings to assist agencies and parties in conducting agency proceedings. Each agency engaged in negotiated rule making shall provide to the Administrative Conference a copy of each report submitted to the agency by a negotiated rule making committee pursuant to section 8 and such additional information as may be required by the Chairman of the Administrative Conference of the United States to enable the Chairman to comply with this subsection. The Administrative Conference of the United States shall review and analyze the reports received under this subsection in each calendar year and shall transmit an annual report to the Congress containing recommendations concerning the use of the negotiated rule making process.

(e) The Administrative Conference of the United States is authorized to provide training in negotiated rule making processes to interested Federal personnel either on a reimbursable or non-reimbursable basis. Such training may be extended to private individuals on a reimbursable basis.

(f) The Chairman of the Administrative Conference of the United States is authorized to pay, upon request of an agency head, all or part of the expenses of convening and conducting a negotiated rule making proceeding. Such expenses may include, but are not limited to, the costs of convenors and mediators, the costs for certain members determined to be eligible for assistance in accordance with section 11(b), administrative costs, and training costs. The determinations with respect to payments under this section shall be at the discretion of such Chairman in furthering the use of negotiated rule making procedures by Federal agencies.

## JUDICIAL REVIEW

SEC. 13. Any agency action pertaining to a negotiated rule making procedure shall not be subject to judicial review. Nothing in this section shall bar judicial review of a rule which is otherwise provided by law.

## AUTHORIZATION OF APPROPRIATIONS

SEC. 14. To carry out this Act, there are authorized to be appropriated to the Administrative Conference of the United States not in excess of $1,000,000 for each of the fiscal years 1988, 1989, and 1990.

# TESTIMONY
# OF
# MARSHALL J. BREGER

## Introduction

My name is Marshall J. Breger and I serve as Chairman of the Administrative Conference of the United States. Accompanying me are Jeffrey S. Lubbers, research director of the Conference, and staff attorney David M. Pritzker. While the views that I am expressing are those of the Conference and not the Administration, I am pleased to be with you at the first of the Committee's hearings in 1988 on issues related to regulatory reform. I am particularly pleased to be invited to speak generally on the subject of negotiated rulemaking, and to discuss S. 1504 in particular, because this is a process that holds great promise for alleviating some of the inefficiency and unpleasantness about the way in which regulatory agencies have gone about the task of formulating rules.

I want to take a moment to explain the institutional basis for my remarks. The Administrative Conference of the United States is an independent agency of the federal government that for twenty years has been working with agencies to improve their administrative procedures. Our recommendations are based on a combination of scholarly research, practical experience, and a continuing dialogue between the Conference and the other agencies. This dialogue is aided by the fact that somewhat more than half of the members of the Conference are high-level officials who represent the various agencies whose programs can benefit from our research and recommendations. Recommendations of the Conference are formally adopted at semi-annual plenary sessions after research, committee discussions, extensive public efforts to obtain the views of interested persons as well as government agencies, and formal debate. My remarks today will be based primarily on recommendations of the Conference adopted in this way, amplified and illustrated by the experience of agencies and others in following the recommended procedures.

In the last few years, the Administrative Conference has devoted substantial attention to exploring improved techniques for resolution of regulatory and other disputes in which the government is either a party or the ultimate decisionmaker. The term "alternative means of dispute resolution" (or "ADR") has come to refer to procedures that make use of negotiation, mediation, arbitration, and various other consensual approaches to resolving disputes. These techniques have been used for years in a variety of private sector settings, resulting in reduced litigation, faster and less costly decisions that are more acceptable to the parties, and the fostering of an attitude of greater cooperation among the parties in future dealings. We believe that similar benefits can be obtained where government agencies adapt ADR to their own needs.

In this spirit, the Administrative Conference twice formally adopted recommendations that encourage agencies to use negotiated rulemaking in appropriate situations.[1] The Conference has also adopted a number of additional recommendations that urge agencies to find ways to make greater use of negotiation techniques in other settings besides rulemaking.[2] We believe that negotiated rulemaking — sometimes called "regulatory negotiation" or "reg-neg" — is part of the same thrust as ADR, and can be viewed as ADR for rulemaking. Recently, Senator Charles Grassley introduced S. 2274, the "Administrative Dispute Resolution Act of 1988," which seeks to spur government use of ADR in adjudication. That bill should be seen as a complement to S. 1504.

## Negotiated Rulemaking

I would like to turn to the particular ADR procedure — reg-neg — with which the Conference has had the most experience, and which is the subject of S. 1504. The problems addressed by the bill are not new ones. Because Congress has largely assigned the task of defining the details of regulatory policy to administrative agencies, and has given the public a role in creating that policy, the process of developing rules that implement environmental, health and occupational safety legislation has, at times, become a battleground for interest groups and other affected parties. As an example, eighty percent of EPA's proposed rules are challenged in court. In other words, after internal agency review and notice and comment procedures, the process is not over. Rather, rulemaking is simply the opening round in the inevitable courtroom litigation.

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[1] Procedures for Negotiating Proposed Regulations, 1 C.F.R. §§ 305.82-4 and 85-5.

[2] Resolving Disputes under Federal Grant Programs, 1 C.F.R. § 305.82-2; Negotiated Cleanup of Hazardous Waste Sites under CERCLA, 1 C.F.R. § 305.84-4; Administrative Settlement of Tort and Other Monetary Claims Against the Government, 1 C.F.R. § 305.84-7; Agencies' Use of Alternative Means of Dispute Resolution, 1 C.F.R. § 305.86-3; Acquiring the Services of "Neutrals" for Alternative Means of Dispute Resolution, 1 C.F.R. § 305.86-8; Assuring the Fairness and Acceptability of Arbitration in Federal Programs, 1 C.F.R. § 305.87-5; Alternatives for Resolving Government Contract Disputes, 1 C.F.R. § 305.87-11

The cost of the rulemaking process, in terms of dollars spent, conflict, and delay is now widely recognized as a major impediment to efficient and effective regulation. Industry groups, public interest organizations, and administrative agencies are all concerned about the cost of regulation. The Administrative Conference believes that negotiated rulemaking (sometimes referred to as "regulatory negotiation" or "reg-neg") offers a means of fostering more cooperative approaches among persons and organizations with an interest in writing and implementing regulations.

In a sense, the search for alternative procedures is not at all new. Administrative adjudication, after all, is often seen as a substitute for litigation in court. In like fashion, administrative agencies were created and given rulemaking authority in part to obviate the need for ongoing congressional legislation. The current search for alternative procedures is an effort to find ways to ameliorate the factors that tend to formalize agency processes and encourage contentious behavior among parties to disputes that now arise before agencies. At the Administrative Conference's June 1987 colloquium on improving government dispute handling procedures, EPA Administrator Lee M. Thomas noted: "[W]e have concluded . . . that regulatory negotiation does work. We term it successful in our agency, particularly when we look at timeliness, the ability to get as much technical information as possible on the table during the development of the regulation, and the issue of litigation of the regulation once it has been completed."

The concept of negotiated rulemaking is quite simple. In ordinary rulemaking, the agency studies a problem through its own staff resources and reaches a tentative solution. It publishes that tentative solution as a proposed rule, and the public has an opportunity to offer comments. The agency then issues a final rule in light of those comments. In negotiated rulemaking, representatives of all affected parties, including the agency, come together in an effort to draft a proposed rule that takes into account the needs of the various interests, as well as the requirements of the underlying statute. The drafting often takes on the quality of labor-management negotiations, with all the give-and-take that such negotiations entail. In the end, if the negotiators can reach consensus, a proposed rule is fashioned, which receives the support, or at least the acquiescence, of all interested parties. If less than total consensus is achieved, the process can still be valuable in identifying and narrowing issues, and in enabling the agency to understand the concerns and viewpoints of all parties.

Among the ancestors of negotiated rulemaking are the experiences of private sector organizations that write voluntary consensus standards such as the National Electric Code, which are widely adopted as regulations by local and state governments throughout the country and by agencies of the federal government. Voluntary consensus standards are typically drafted through a negotiation process that is followed by some kind of publication with an opportunity for comment. Other experience that suggests the value of negotiation procedures includes growing use of mediation to resolve environmental disputes and numerous negotiated settlements of lawsuits challenging rules. Reg-neg is an attempt to draw on these experiences to improve rulemaking in federal regulatory programs.

Negotiated rulemaking brings into the regulatory process representatives of the people who have real interests at stake, and it does so at an early stage. It gives them the opportunity to discuss their mutual problems and their differing views in a setting that fosters cooperation. Moreover, each participant knows that failure to reach a consensus on a draft rule will inevitably result in the agency drafting the rule by itself. Thus the immediate attraction to participants is to "get in on the ground floor" before the rule takes shape, to be listened to, and to take responsibility for finding creative solutions that will recognize the legitimate needs of the other affected parts of society.

It must be stressed that such compromise solutions are in no way an abdication of agency responsibility. The agency has a continuing obligation to participate fully in the negotiations to assure that statutory requirements are met and that any agreement is basically fair. The agency cannot simply sit back and automatically accept as its policy whatever resolution of issues the competing interest groups in a reg-neg hammer out. In fact, however, it is the participation of representatives from the spectrum of different interests that serves as a primary guarantee of fairness. Additional protection is guaranteed by the fact that reg-neg is primarily a substitute for the drafting stage of the rulemaking process. Therefore, a proposed rule published by an agency and based on a consensus of representatives of the affected interests is still subject to the notice and comment provisions of the Administrative Procedure Act. In practice, where consensus is reached by the negotiating committee, the time, effort, and expenses involved in filing and responding to such comments is likely to be relatively small.

In 1982, the Administrative Conference completed the first study of the potential for using negotiation techniques in federal agency rulemaking. Based in part on a report by Washington attorney Philip J. Harter, the Conference adopted Recommendation 82-4, Procedures for Negotiating Proposed Regulations. This recommendation set forth guidelines and criteria for the selection of regulatory problems that seemed conducive to trying to get representatives of affected interests to attempt to negotiate a solution. The Conference also set forth procedures that we believed would enable agencies to incorporate the negotiation of proposed rules into agency rulemaking proceedings. These guidelines and procedures have formed the basis of the successful use of reg neg by EPA, FAA, and a growing number of other agencies.

The Conference, in 1982, viewed negotiated rulemaking as an experiment that would have to be reexamined after a reasonable number of attempts to use it. In 1985, we reassessed our earlier recommendation on reg-neg in the light of agency experience, and adopted Recommendation 85-5, which refined and supplemented the original recommendation. Lessons learned from that study concerned the role of the regulatory agency in negotiations, the value of having one or more skilled mediators participate, and the usefulness of small-scale training opportunities. We also saw that in some instances it would be desirable to have a "resource pool" to support travel, training, or other appropriate expenses incurred by participants or expended on behalf of the negotiating group.

The Administrative Conference has continued its efforts to acquaint other agencies with the potential value of negotiated rulemaking. We have regularly assisted agencies through informal discussions of procedural issues, creation of a working group to discuss reg-neg procedural issues, drafting notices, and suggesting sources of mediators. In 1987, we conducted a government-wide symposium on alternative means of dispute resolution including extensive discussion of negotiated rulemaking, the proceedings of which have been published in American University's *Administrative Law Journal*. My staff is currently preparing for publication this summer a *Sourcebook on Negotiated Rulemaking* that will be a compendium of background information plus practical advice to agencies considering or conducting negotiated rulemaking proceedings.

## Agency Experience with Negotiated Rulemaking

The first agency to start, and to complete, a negotiated rulemaking proceeding was the Federal Aviation Administration. The FAA's negotiated rule was a revision of flight and rest time requirements for domestic airline pilots. The agency's prior rules had been in effect for approximately 30 years. This was a period of substantial change in the airline industry, and the FAA had found it necessary to issue more than 1000 pages of interpretations. Moreover, on several previous occasions, the agency had made proposals for revising the rules, but withdrew them because of substantial opposition.

With the encouragement and assistance of the Administrative Conference, FAA assembled a negotiating committee consisting of representatives of airlines, pilot organizations, public interest groups, and other interested parties. After an initial notice in the *Federal Register* announcing the forthcoming proceeding and naming the proposed participants, requests to participate were received from other interested parties, and some of them were added to the negotiating group. Negotiations took place in 1983, and the FAA published a notice of proposed rulemaking based on the negotiations in early 1984. The negotiating group was consulted again by the agency, and a final rule was adopted in 1985. The rule was not challenged in court. In 1987, the Department of Transportation again decided to use reg-neg, and convened a committee to negotiate a proposed rule concerning non-discrimination on the basis of handicap in air travel, implementing the Air Carrier Access Act of 1986. Negotiations have been completed and the Department is now drafting a rule based on the negotiations.

While the FAA was proceeding with its reg-neg, the Environmental Protection Agency also explored opportunities to use the procedures recommended by the Administrative Conference. Following the suggested criteria, EPA selected two regulatory problems for reg-neg. Rules were successfully negotiated dealing with penalties for manufacturers of vehicles not meeting Clean Air Act Standards and emergency exemptions from pesticide regulations. Other rules adopted by EPA based on negotiations address performance standards for woodburning stoves and inspection and abatement of asbestos-containing materials in school buildings. The school asbestos rule is the first rule based on negotiated rulemaking to be challenged in court, with oral argument held before a panel of the Court of Appeals for the District of Columbia Circuit on March 31, 1988. While the court's decision is still pending, I note that the appeal was based on the content of the rule, and did not challenge the negotiation procedure. EPA's commitment to using reg-neg is underscored by its establishment of an office with ongoing responsibility for making reg-neg a success.

The Occupational Safety and Health Administration has attempted to use negotiations in connection with two of its rules: standards for worker exposure to benzene and exposure to a carcinogen known as MDA (methylenedianiline) that is used in the manufacture of plastics. The benzene negotiations did not result directly in a draft rule, but did serve to narrow the issues in a useful manner. The MDA committee did reach a consensus on a proposed rule.

Two other agencies currently using reg-neg are the Minerals Management Service of the Department of the Interior and the Nuclear Regulatory Commission. Interior reports that discussions are continuing on proposed air quality regulations for oil exploration, production, and development for the outer continental shelf off the coast of California. The NRC's reg-neg committee was formed to negotiate a proposed rule on submission and management of documents relating to the licensing of a geologic repository for disposal of high-level radioactive waste. Committee meetings began in September 1987 and were planned through May 1988. However, the composition of the negotiating committee was later revised to reflect the narrowed focus on a single site in Nevada for a geologic repository, as provided in the recently enacted Nuclear Waste Policy Amendments Act of 1987.

## Specific Provisions of S. 1504

In essence, S. 1504 sets up a framework for agencies to establish rulemaking negotiating committees in accord with recommendations of the Administrative Conference and following the model successfully used by EPA, FAA, and OSHA. The bill formally establishes the Conference as a clearinghouse of information and experience with reg-neg, and utilizes the Conference's expertise to keep the Congress continually informed as to how the process is working.

The bill also addresses two concerns that have previously discouraged agencies from giving serious consideration to reg-neg. First, the bill clarifies the applicability of the Federal Advisory Committee Act to reg-negs. Second, the bill authorizes funds to assist agencies in implementing the negotiated rulemaking process, to provide training, and to pay certain expenses of negotiating committees.

On the first point, while the Federal Advisory Committee Act has not yet caused serious problems for agencies using reg-neg, the state of the law is somewhat unclear regarding the ability of subgroups of a negotiating committee to meet privately. Such meetings or "caucuses" may be very useful to develop alternatives for consideration by the committee or, in the case of allied interests, to determine a negotiating position. Rightly or wrongly, the fact is that many agencies are afraid to enter into reg-negs because of FACA fears. The language of section 11(b) is particularly helpful in clarifying this matter so as to remove this potential cloud on the use of reg-neg.

S. 1504 is designed to encourage agencies to consider using negotiated rulemaking, and not to give individual parties additional rights. In particular, we do not wish to see additional sources of potential litigation created. To this end, section 13 provides that agency actions pertaining to procedural decisions in reg-neg are not subject to judicial review. We believe that this is a critical provision of the bill and must be included in any legislation on negotiated rulemaking that is enacted.

We note that, to carry out the purposes of S. 1504, the bill authorizes appropriations to the Administrative Conference up to $1 million for each of the fiscal years 1988, 1989, and 1990. While some start-up costs may engender reluctance initially, agencies will enjoy substantial long-term savings from reductions in expected litigations costs and, perhaps, reduced costs of agency compliance efforts. With regard to the Conference, I anticipate that, in 1988 and 1989, we would rely on our current appropriations.

On a related point, it would be helpful to include in the bill a provision that would expressly permit the Conference to handle private funds that could become available to pay expenses that may not be properly borne by the government, such as some expenses of participation by essential, but impecunious parties. This is a role that has sometimes been played by the National Institute for Dispute Resolution because there is no government entity at present to perform this role. I note that our existing statute authorizes the Conference to accept and utilize outside gifts and contributions, 5 U.S.C. §575(c)(12), so adding a reference to that provision should suffice.

The bill's other provisions that call for both consultative and reporting roles for the Administrative Conference, we believe, to be of value. In addition to aiding particular reg-neg efforts, the Conference can continue to play a vital role in further development of both the theory and practice of reg-neg. Encouraging agencies to consult with the Conference as they undertake to convene reg-negs will help assure that the procedure is being continually improved.

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June 21, 1988

OFFICE OF
THE CHAIRMAN

Senator John Glenn, Chairman
Senator Carl Levin, Subcommittee Chairman
Committee on Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Senators Glenn and Levin:

I appreciated the opportunity to appear before the Committee on Governmental Affairs, on May 13, 1988, to discuss S. 1504, the "Negotiated Rule Making Act." The following are my responses, on behalf of the Administrative Conference, to the questions asked by Senator Sasser and enclosed with your letter of May 24, 1988.

Question (1) Do you think that this negotiated rulemaking procedure should be favored more highly under any particular circumstances? For example, do you think negotiated rulemaking is more desirable when the issue is a highly contentious one, or is being promulgated by any particular agency, or for a rule that is of particularly broad scope?

Answer Negotiated rulemaking is more likely to be of value in rulemaking proceedings that have certain features. Administrative Conference Recommendation 82-4 (paragraph 4) identified various criteria to guide agencies in selecting candidates for the process. These criteria are as follows:

> (a) The issues to be raised in the proceeding should be mature and ripe for decision. Ideally, there should be some deadline for issuing the rule, so that a decision on a rule is inevitable within a relatively fixed time frame. The agency may also impose a deadline on the negotiations.
>
> (b) The resolution of issues should not be such as to require participants in negotiations to compromise their fundamental tenets, since it is unlikely that agreement will be reached in such circumstances. Rather, issues involving such fundamental tenets should already have been determined, or not be crucial to the resolution of the issues involved in writing the proposed regulation.
>
> (c) The interests significantly affected should be such that individuals can be selected who will adequately represent those interests. Since negotiations cannot generally be conducted with a large number of participants, there should be a limited number of interests that will be significantly affected by the rule and therefore represented in the negotiations. A rule of thumb might be that negotiations should ordinarily involve no more than 15 participants.
>
> (d) There should be a number of diverse issues that the participants rank according to their own priorities and on which they might reach agreement by attempting to optimize the return to all the participants.

(e) No single interest should be able to dominate the negotiations. The agency's representative in the negotiations will not be deemed to possess this power solely by virtue of the agency's ultimate power to promulgate the final rule.

(f) The participants in the negotiations should be willing to negotiate in good faith to draft a proposed rule.

(g) The agency should be willing to designate an appropriate staff member to participate as the agency's representative, but the representative should make clear to the other participants that he or she cannot bind the agency.

The Conference's recommendation also suggests consideration of "the risks that negotiation procedures would increase the likelihood of a consensus proposal that would limit output, raise prices, restrict entry, or otherwise establish or support unreasonable restraints on competition."

The experience of the agencies that have used negotiated rulemaking indicates that these criteria are, in fact, a practical guide that has assisted those agencies. S. 1504 incorporates some of the same points in section 5.

Question (2) Are there any circumstances under which you believe negotiated rulemaking should be made mandatory?

Answer We believe that negotiated rulemaking should ordinarily not be mandatory. The success of the negotiated approach to rulemaking requires a combination of factors, including a mutual desire of the agency and the other parties to work toward achieving consensus through negotiations. The existence of such motivation may be unpredictable. We believe that a decision to use this approach should be made on a case-by-case basis, taking into account the criteria identified in the answer to question (1).

We note that in the "Augustus F. Hawkins-Robert T. Stafford Elementary and Secondary School Improvement Amendments of 1988," Congress has required the Secretary of Education to issue regulations developed pursuant to a modified negotiated rulemaking process and expressly directs the Secretary to "follow the guidance provided [by] the Administrative Conference of the United States in Recommendation 82-4." (Section 1001 of Public Law 100-297, amending section 1431 of the Elementary and Secondary Education Act of 1965; 102 Stat. 189). We shall be following with interest the progress of the proceedings conducted under this statutory directive.

If any further questions arise, I would be pleased to furnish further information or explanations.

Sincerely yours,

Marshall J. Breger
Chairman

Enclosure

cc: Senator Jim Sasser

MJB:DMP/sda

STATEMENT OF
THOMAS E. KELLY
DIRECTOR
OFFICE OF STANDARDS AND REGULATIONS
OFFICE OF POLICY, PLANNING, AND EVALUATION
U.S. ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
U.S. SENATE

May 13, 1988

Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to be here today to discuss the Environmental Protection Agency's experience with negotiated rulemaking and our views on S. 1504. Since your letter gave us some knowledge of your concerns, I have organized my testimony to address the issues you raised.

## EPA's Experience with Negotiated Rulemaking--The Utility and Practicality of Face-to-Face Negotiations among Affected Parties

EPA's experience with regulatory negotiation has been a positive one. An analysis performed recently by our Program Evaluation Division -- and which we request be made a part of the formal record (Attachment #1) -- indicates that negotiated rulemaking can sometimes be better than the conventional rulemaking process.

In the "right" situations, negotiated rulemaking can produce proposed rules that meet statutory requirements but which are more pragmatic than proposals EPA might develop on its own, and may produce better environmental results. In addition, negotiated rules are more likely than conventional rules to be accepted by the affected industries and other interested parties involved in developing them. Negotiation also may reduce the time it takes to proceed from proposed to final rulemaking.

Picking the "right" situations, however, is critical. Frequently undertaking negotiations in cases where they are inappropriate or unlikely to produce consensus could eventually discredit the process. Therefore, our experience to date demonstrates that, although negotiated rulemaking has many benefits, the number and types of rules to which it applies are limited. Nevertheless, we see strong benefits from a continuation of our involvement in negotiated rulemaking.

Negotiated rulemaking is a dramatic, visible symbol of EPA's commitment to breathe fresh air into the regulatory decision process. The experience of having participated in a negotiated rulemaking opens up minds, doors, and meeting tables to a fuller, less acrimonious consideration of other regulatory issues, even outside the framework of a given negotiation. For EPA, negotiated rulemaking is an essential and the most prominent technique among many the Agency is applying to open up the rulemaking process, to reduce unnecessary policy conflict, to build consensus --or at least respectful understanding of legitimate differences-- and to scale back the endless cycle of regulate and litigate, regulate and litigate.

The seven negotiations we have completed so far produced the following utilitarian and practical results.

| | |
|---|---|
| 1. Non-conformance penalties<br>- Procedures for determination of penalties to be paid by manufacturers of heavy-duty engines that cannot meet EPA standards | Rule proposed on March 6, 1985. Only 13 comments, all supportive, were received. Consensus reached on all issues. Final rulemaking published August 30, 1985. No litigation. |
| 2. Pesticide emergency exemptions<br>- Procedures for EPA approval of State requests for emergency use of unregistered pesticides | Proposed rule published April 8, 1985. Only nineteen comments, all minor in nature,received. Consensus reached on exact language of proposed rule.<br>Final rulemaking published January 15, 1986. No litigation. |
| 3. Farmworker protection<br>- Requirements for protective clothing and equipment, warning of hazards, re-entry intervals, and other items | Negotiations broke down. EPA has developed proposed rule which it will issue shortly. |
| 4. RCRA permit modifications<br>- Procedures for State/EPA approval of modifications to RCRA permits for hazardous waste facilities. | Consensus on all issues, except that one member dissented on one issue.<br>A proposed rule on Sept. 23, 1987. 55 comments received. Publication of final rule scheduled for late summer. |
| 5. Underground injection of hazardous wastes<br>- Rules for siting, construction, operation, monitoring, and closure of hazardous waste injection wells. | Informal agreement reached on some of the issues. EPA published proposed rule on August 27, 1987. Nearly 30 public comments received. We plan to publish our final rule in early June. |

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|---|---|
| 6. Woodstoves New Source Performance Standard | |
| - Emission standards and testing requirements applicable to new residential wood-burning stoves | Consensus reached on exact language of proposed rule. Proposal published on February 18, 1987 and drew some fifty comments. Final rule published on February 26, 1988. No litigation expected. |
| 7. Asbestos in schools | |
| - Requirements for identification and mitigation of asbestos hazards in public and private elementary and secondary schools. | Limited accord--with reservations-- achieved on many issues. About 150 public comments submitted; many critical of key provisions of the proposal. Final rule issued on time on October 30, 1987. Litigation has ensued which according to EPA Counsel and the Lead Office: (a) was greatly limited as to issues & number of plaintiffs, and (b) was supported by many of the negotiation members who intervened to support EPA's approach. |

Our project descriptor -- submitted as a formal part of the record as Attachment #2 -- describes the regulatory negotiation process and the individual negotiations in considerably more detail.

Factors to Consider in Deciding whether to Convene a Negotiated Rulemaking, or whether to Adopt a Negotiated Rule

Our criteria for selecting rules for negotiation are:

Criteria for the Item

- The proposal should require the resolution of a limited number of interdependent or related issues, none of which involves fundamental questions of value. There must be a sufficiently well-developed factual base to permit meaningful discussion and resolution of the issues. There should be several ways in which the issues can be resolved.

- To promote timely resolution, and to limit a participant's ability to gain from delay, there should be a legislative or judicially imposed deadline or some other mechanism forcing publication of a rule in the near term, i.e., eight to 12 months.
- Some or all of the parties should have a common position on one or more of the issues to be resolved which might serve as a basis for agreement during the course of negotiations.
- The costs and benefits should be narrowly concentrated on a few identifiable entities.

Criteria for the Participants

- Those participants interested in or affected by the outcome of the development process should be readily identifiable and relatively few in number. Participants should be able to accurately represent and reflect the interests of their constituencies.
- The parties should be in good faith about wanting to participate in negotiations. They should feel themselves as likely, if not more likely, to achieve their overall goals by using negotiation instead of existing alternatives.
- The parties should view themselves as having an ongoing relationship with the Agency beyond the item under consideration.

Our evaluation supports the continuous use of these criteria. In addition, EPA's experience thus far suggests that negotiated rulemaking will work best (i.e., most likely result in consensus on proposed rules) when all or most of the following additional conditions exist:

- Rulemaking involves 'second-tier-rules' affecting program implementation--rather than rules establishing program structures. The RCRA Permit Modification and Non-conformance Penalty rules are excellent examples of 'second tier' rules.

- Rulemaking does not involve any extremely controversial national policy or complex multi-media issues. Rules setting national standards often will involve extremely controversial issues. The Woodstoves NSPS rulemaking did not; in addition, it related only to air quality.

- The principal parties have (or can reasonably be expected to agree upon) common goals. For example, participants in the RCRA rulemaking were united in wanting to reform the process for review of permit modifications.

- The policy implications of the issues to be resolved are more-or-less limited programmatically, i.e., the rule-making will not establish precedents that will be binding in program areas not encompassed by the negotiations.

- Where complex scientific and technical issues must be resolved, the necessary data should be readily available. While negotiators may bring some relevant data to the table, negotiated rulemaking is certainly not the only way, nor is it necessarily the best way, to obtain data, especially detailed scientific and technical data on the nature and extent of health and environmental risk and on the technological and economic feasibility of alternative solutions.

- Ongoing litigation should be carefully analyzed to ensure that it will not affect participants' willingness or ability to engage in genuine give-and-take. In one negotiated rulemaking that achieved only partial success representatives of the parties involved in litigation could not accept an outcome that would prejudice their case.

- The time available for negotiations is adequate. The length of intervals between negotiating meetings is the best measure of the adequacy of time for negotiations. It must be long enough to allow participants to digest and reflect on what has taken place, to talk to one another informally (if they wish), to consult the groups they represent, and to prepare for upcoming meetings. In most of the negotiated rulemakings EPA has undertaken, this interval generally has been four weeks, which has been adequate.

The Agency's first seven choices of rulemakings for negotiation reflect reliance on the selection criteria, tempered in some cases by program managers' judgments that negotiations would be worthwhile even though full consensus might not be achieved.

In both the Farmworker Protection and Underground Injection of Hazardous Waste cases, the EPA Program Managers who initiated the negotiations recognized that there were serious obstacles to achieving full consensus. In both instances, however, reaching consensus and/or bringing the parties closer together on some issues presented opportunities to learn more about "real world" conditions relevant to the rulemaking.

Similarly, in the Asbestos case, the Program Managers recognized the possibility that consensus would not be reached, particularly because of the limited time available and the large number of issues, but they made a judgment that attempting a negotiation would nevertheless be worthwhile, since the process would involve many of the same groups that had worked together during Congressional consideration of the underlying legislation.

## Actual Expenditures and Estimated Cost-Effectiveness.

Attachment #3 depicts the amount of contract and support dollars we have spent for our negotiations to date. As you will see, we spent an average of $18,709.57 on convening, $43,366.14 on facilitation, $2,357.14 on analysis, $24,351.57, on travel and per diem, $5,416.29 for consultants, for an average of $94,200.71 per negotiation.

Convening refers to the careful evaluation and consultation activities which precede the formation of each committee and start of actual negotiations. Facilitation refers to the process-meeting management support provided for each committee by a neutral party. Analysis refers to the two occasions where we asked our convenor/facilitator to analyze lessons learned from their activities. The travel and per diem expenses covered those costs for indispensible parties. The costs for consultants were for support deemed necessary by committee members and approved and requested in accordance with their committee's resource pool protocols.

EPA's recently completed evaluation was careful to note that:

> Whether . . . [EPA's negotiated rulemaking activities resulted] . . . in a net savings could not be determined, and, perhaps, can never be determined, because the Agency does not keep records of its resource utilization separately for each rulemaking effort; EPA generally has no need for such detailed data.

Based on this study, it appears that pre-proposal costs are reduced only slightly, if at all. If, however, final rulemaking is easier, there may be some savings. If litigation is avoided, and if affected industries' acceptance of the rulemaking produces a high degree of voluntary compliance, all parties may reap substantial savings.

In addition, the evaluation found that developing proposed rules through negotiation made final rulemaking easier and less costly. Going from proposed to final rulemaking has been easier and less resource-intensive than it ordinarily is. This was true in the Nonconformance Penalty, Pesticides Emergency Exemptions, and Woodstoves NSPS rulemakings. For the Woodstoves NSPS, the Office of Air Quality Planning And Standards spent about one-half as much time and money as it ordinarily would expect to spend for additional data collection and analysis in order to respond to public comments; this represents a saving of about $150,000. Even more significant is the fact that final rulemaking was completed on schedule.

S. 1504, The Negotiated Rulemaking Act.

Few agencies have more experience or more strongly support the appropriate use of negotiated rulemaking than does EPA. We have had a number of successful experiences with this approach and anticipate more in the future.

Indeed, our Administrator, Lee M. Thomas, manages our Agency around seven management themes, one of which deals with negotiation and consultation.

With regard to this theme, Mr. Thomas has said:

> In finding solutions, we will expand the use of negotiated regulations and consultative proceedings with a wide range of representatives from industry, environmental organizations, state and local governments, and the general public.

S. 1504 would not change EPA's authority to engage in negotiated rulemaking. Rather, the proposal would encourage use of the technique by having the Administrative Conference of the United States (ACUS) establish an information clearing-house, assist in conducting rulemakings, and defray the expenses of

Agency negotiated rulemaking proceedings. S. 1504 would explicitly apply the provisions of the Federal Advisory Committee Act (FACA) to such proceedings.

While we support the objectives of S.1504 without reservation, we are somewhat less firm in our support of the mechanics established by the proposal itself. Our reservations turn on questions regarding the proposal's necessity and efficacy.

Let me register some general concerns and offer several specific suggestions.

### General Comments:

First, S. 1504 seems to assume that, when used properly, a negotiated rulemaking will become the sole means by which interested parties will seek to affect regulatory outcomes. However, we believe that participants to a negotiation may also choose to pursue other avenues of influence such as lobbying and litigation, in addition to participating in the negotiation. Thus, negotiated rulemaking can simply become one among several means of achieving a desired end.

Second, we believe that the negotiated rulemaking process will normally work effectively only in limited circumstances, generally when each of the participants in the negotiation feels that a great deal may be lost in the conventional forums if any agreement is not reached.

Finally, Sections 6 and 7 of the Bill clearly provide that interested individuals may apply for membership on a negotiated rulemaking committee. An agency's authority to accept or reject such applications is somewhat vague. Based upon our experience, we believe it would be helpful if the Bill would make clear that such decisions are within the authority and discretion of an agency based upon a review of the applications.

Specific Suggestions:

Section 4: Definitions:

Subsection (9) defines "mediator" and uses it throughout to refer to the third party neutral who provides at-the-table services during negotiations. The term, "facilitator" is not defined or used.

A "mediator" is often held to be one who is or can be involved in the substance as well as the process of the negotiated outcome. We are careful in our negotiations to call our process support people "facilitators" and limit their role to process support unless --- during negotiations --- the parties demand more. We suggest that the term, "facilitator" should be defined and used instead of or in addition to the term, "mediator."

Section 5: Determining the Need for a Negotiating Committee:

Subsection (a)(7) says that agencies will use consensus " . . . to the maximum extent possible." To help allay concerns and anticipate confusion, this section could be amended to state the fact that all statutory and other legal findings and requirements must be met.

Section 7: Establishing Negotiating Committees:

Subsection 7(b) says that the persons representing interests must be "likely" to reach consensus. This is a very high standard. It might be better to say: "in good faith about wanting to achieve" consensus.

Section 8: Conducting Negotiations:

Subsection (g) requires the committee to prepare and transmit a report to the Agency. We feel it would be better to delete this requirement. It would be preferable to leave it to the group to define its product. A report could turn into a forum to reopen or relobby issues.

Section 12: Administrative Conference of the United States Role:

Subsection (a) says that agencies "should" consult with ACUS for assistance in forming a committee. We would prefer to say "may consult with ACUS, which has agreed to play a clearing-house role."

Subsection (b) says ACUS will maintain a roster of persons "qualified" to act as convenors or "mediators." "Qualifying" people for services is a difficult and contentious business. Instead, we suggest that this section say that ACUS will maintain a roster of persons ". . . who have acted as or are interested in serving as convenors, facilitators, mediators, etc."

Subsection (d) requires agencies to file additional information "required by the chairman of ACUS." If the purpose of this rule is to encourage additional participation, requirements should be kept to a minimum, so we suggest deleting this provision.

Section 13: Judicial Review:

The impacts of this section are unclear, and we would suggest amending it for clarification.

Mr. Chairman, this concludes my prepared statement. Thank you again for the opportunity to be here today. I would be happy to attempt to respond to any questions you may have, either now or later in writing.

* * *

ATTACHMENT #1

## An Assessment of EPA's Negotiated Rulemaking Activities

Program Evaluation Division
Office of Management Systems and Evaluation
Office of Policy, Planning and Evaluation

December 1987

This report presents the findings of a study of EPA's Negotiated Rulemaking activities. The Program Evaluation Division (PED) conducted the study at the request of the Director of the Office of Standards and Regulations (OSR) in EPA's Office of Policy, Planning and Evaluation (OPPE). OSR is the organizational 'home' of the Regulatory Negotiation Project staff, which conceived and designed the undertaking and is responsible for coordinating, and providing administrative and logistical support to. EPA's negotiated rulemaking activities.

### Section 1: Main message

PED's analysis indicates that negotiated rulemaking can sometimes be better than the conventional rulemaking process. In the 'right' situations, negotiated rulemaking can produce proposed rules that meet statutory requirements but are more pragmatic than proposals EPA would be likely to develop on its own and may produce better environmental results; in addition. negotiated rules are more likely (than conventional rules) to be accepted by the affected industries and other interested parties involved in developing them. Negotiation also may reduce the time it takes to proceed from proposed to final rulemaking. Picking the 'right' situations is critical; frequently undertaking negotiations in cases where it is inappropriate or unlikely to produce consensus could eventually discredit the process.

### Section 2: Background

EPA has about 200 to 250 rulemaking activities underway at all times. Nearly all are conducted in accordance with the notice-and-comment requirements of the Administrative Procedure Act (i.e., 'conventional' rulemaking). In conventional rulemaking, EPA gathers data from various sources and may have informal meetings with interested or affected groups to seek information and/or test ideas. EPA then decides on the content of a proposed rule and publishes it. All interested parties may submit written comments, and, the Agency frequently receives many detailed comments; in addition. the Agency sometimes holds public hearings. After reviewing the comments and any testimony presented at hearings, the Agency must prepare and publish a final rule; doing so usually takes several months, sometimes years. About 80 percent of EPA's final rules are challenged in court.

Four years ago, the Agency announced [1] that it would undertake a pilot-project to investigate the value of negotiated rulemaking, identify the types of regulations most appropriate for negotiation. and determine how best to conduct such negotiations. In negotiated rulemaking, a designated EPA official [2] and representatives of groups interested in and/or affected by a rulemaking activity have a series of meetings in which they attempt to reach consensus on all or the most important features of a proposed rule. This negotiating committee is chartered as an Advisory Committee under the Federal Advisory Committee Act; its plenary and subcommittee meetings are open to the public. To the extent that any consensus reached by the negotiating committee is consistent with the Agency's statutory authority, EPA is committed to using it as the basis of a Notice of Proposed Rulemaking (NPRM).

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[1] *Federal Register*. February 22, 1983, Vol. 48, No. 36. Pg. 7494.

EPA's criteria for selecting rulemakings for negotiation [3] are aimed at identifying situations in which negotiations have a 'high probability of success.' Toward this end, the criteria reflect a preference for rulemakings in which all or many of the following conditions exist:

- There is a limited number of interrelated issues to be resolved. There are several ways in which they can be resolved. The relevant statutes must accommodate these options.
- There are no serious obstacles to reaching consensus. i.e., the rulemaking will not challenge participants' fundamental values.
- There is a statutory or judicial deadline for completing the rulemaking or some other action-forcing mechanism.
- The prospective participants share common ground on at least some of the issues to be negotiated.
- The costs and benefits of the rulemaking are concentrated on a few entities.
- There are relatively few interested and affected parties--and they are readily identifiable.
- The prospective participants are willing to negotiate in good faith.
- The prospective participants see themselves as having on ongoing relationship with EPA.

Once a proposed rule is published, rulemaking proceeds in accordance with the Administrative Procedures Act and other applicable statutes; that is, the Agency considers public comments and prepares and publishes a final rule. Negotiating committees have played no formal role in final rulemaking; in some cases, however. EPA has informally (but on-the-record) talked with them about the public comments on the proposed rules.

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[2] In the seven negotiated rulemakings undertaken thus far. Office Directors have served as EPA's negotiators four times; in the other three. the EPA negotiator was a deputy Office Director, a division director, and a branch chief.

[3] The Federal Register notice cited in Footnote No. 1 described the selection criteria. Since that time, the only substantive change has been the addition of a statement that the 'parties should view themselves as having an ongoing relationship with the Agency...'.

## Section 3: Purposes and methods of the study

Thus far, EPA has undertaken negotiated rulemaking seven times. PED's study was aimed at determining how well negotiated rulemaking has worked, how it compares with conventional rulemaking, and investigating whether and how EPA could make improvements in its criteria for selecting rulemakings for negotiation. Whether consensus had been achieved was among the factors taken into account in this study, but PED also looked at such questions as whether the negotiations produced better information or better results than the Agency ordinarily gets from the conventional rulemaking process in the pre-proposal stage.

For these purposes, the PED Project Team reviewed relevant materials, including published literature on regulatory negotiation, the documentation of EPA's first two negotiated rulemakings [4] [5], minutes and summaries of the meetings of negotiating committees, texts of negotiated proposals, and other public documents. The Project Team also interviewed many EPA managers and staff members and other people who have participated in the seven negotiated rulemakings undertaken thus far, as well as some of the people who have served as convenors and facilitators.

In performing this assessment of EPA's negotiated rulemaking activities, PED necessarily used people's subjective views as raw material, although interviewees were always asked to provide--and frequently did provide-facts and examples to support their statements. Also, it must be emphasized that a controlled comparison of negotiated and conventional rulemaking could not be made. One of the seven negotiated rulemakings (the one dealing with the process for review and approval of RCRA permit modifications) dealt with the same subject that had been addressed in a previous proposal developed through conventional rulemaking. Another one (i.e. the New Source Performance Standards for residential wood-burning stoves) was at least conceptually similar to the many other New Source Performance Standards developed over the past 15 years. Thus, PED had some empirical basis for comparing conventional and negotiated rulemaking, but, in both instances, the conventional and negotiated proposals were developed at different times and under different regulatory situations.

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[4] Documention of EPA's Non-conformance Penalties Regulatory Negotiated Rulemaking Demonstration. Prepared by Lawrence Susskind and Jerry McMahon. Program on Negotiation. Harvard Law School. January 1985.

[5] Documentation of EPA's Pesticide Exemption Regulatory Negotiation. Prepared by Lawrence Susskind and David Kronenberg. Program on Negotiation. Harvard Law School. July 1985.

Section 4: Summary of EPA's negotiated rulemaking activities

Here are descriptions of the subjects of the seven negotiated rulemaking efforts undertaken thus far--together with characterizations of the outcomes.

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|---|---|
| Non-conformance penalties | |
| - Procedures for determination of penalties to be paid by manufacturers of heavy-duty engines that cannot meet EPA standards | Consensus reached on all issues. Final rulemaking has been completed. No litigation. |
| Pesticide emergency exemptions | |
| - Procedures for EPA approval of State requests for emergency use of unregistered pesticides | Consensus reached on exact language of proposed rule. Final rulemaking has been completed. No litigation. |
| Farmworker protection | |
| - Requirements for protective clothing and equipment, warning of hazards, re-entry intervals, and other items | Negotiations broke down. EPA is developing proposed rule. |
| RCRA permit modifications | |
| - Procedures for State/EPA approval of modifications to RCRA permits for hazardous waste facilities | Consensus on all issues, except that one member dissented on one issue. EPA has published proposed rule. |
| Underground injection of hazardous wastes | |
| - Rules for siting, construction, operation, monitoring, and closure of hazardous waste injection wells | Informal agreement was reached on some of the issues. EPA has published proposed rule. |
| Woodstoves New Source Performance Standard | |
| - Emission standards and testing requirements applicable to new residential wood-burning stoves | Consensus reached on exact language of proposed rule. EPA will publish final rule on schedule. |
| Asbestos in schools | |
| - Requirements for identification and mitigation of asbestos hazards in public and private elementary and secondary schools. | Limited accord—with reservations--achieved on many issues. About 150 public comments submitted; many were critical of key provisions of the proposal. |

## Section 5: Findings

FINDING NO. 1: Negotiated rulemaking proposals have been more pragmatic in some respects, and could produce better environmental results in some instances, than those EPA probably would have developed through conventional rulemaking.

Examples supporting this finding are numerous. Even in the case of underground injection of hazardous waste, in which consensus was not reached, EPA's proposed rules are more pragmatic in some respects, and could produce better environmental results, than those the Agency probably would have developed on its own.

### Nonconformance penalties

- In the event of nonconformance, the number of tests to be conducted to determine penalty can range from 4 to 26. Manufacturers have three options for deciding on the number of tests; thus, they can make trade-offs between the number of tests and potential penalties. EPA probably would have required the maximum number of tests in all cases.

- Penalty rates are increased year-by-year. How quickly they increase depends on how much manufacturers use them--the more they are used (i.e., the more often that nonconformance occurs), the more quickly they increase in order to provide incentives for correcting nonconformance. This approach was developed at the negotiating table.

### RCRA permit modifications

- Permit modifications are divided into three classes. Routine modifications having no environmental significance (Class 1 modifications) generally will not require prior State/EPA approval.

- Class 2 permit modifications are automatically approved if the authorized State agency or EPA fails to act within a specified time.

- State/EPA can give a permittee temporary authorization to proceed with facility modifications needed for proper waste managment and/or protection of human health and the environment while the permittee's request for a permit modification is being reviewed.

- Public has opportunities for more informal participation than EPA would have proposed; informal procedures generally are less expensive and less adversarial than formal hearings.

### Underground injection of hazardous wastes

- The provisions of the proposed rule—including those defining and setting conditions for demonstrating 'no migration'—are more comprehensive and explicit than they otherwise would have been.

- The use of fluid seals will be allowed under certain conditions; EPA had not planned to allow them, but information brought to the negotiations satisfied the Agency that fluid seals are sometimes adequate.

- Requirements for groundwater monitoring around hazardous waste wells will be worked out case-by-case in accordance with criteria set forth in the proposed rule. EPA had planned to require well owners/operators to conduct monitoring in accordance with prescribed regimes.

- The area that must be checked for the presence of abandoned wells will be larger than EPA had planned to propose.

- Post-closure care provisions are included; EPA had not planned to include such provisions.

Woodstoves NSPS

- Manufacturers agreed to comply with the proposed standards by mid-1988--at least two years earlier than they could have come into compliance if they had waited for issuance of final standards. They were willing to agree to quicker compliance based on confidence in the consensus achieved by the negotiating committee.

- Manufacturers must perform self-audits of selected woodstoves coming off their production lines, but they will not be subject to 'look-back' penalties if any models later are found in violation. EPA will have the right to test some production-line woodstoves to assure that manufacturers' testing is reliable.

- Manufacturers already certified in Oregon are exempt from additional testing to demonstrate compliance with EPA's initial standards.

- One-year certification of compliance is automatic if a manufacturer encounters delays in getting testing done or getting EPA to review test results.

- The negotiating committee came up with a method of measuring emissions that is more accurate than the one EPA had suggested.

FINDING NO. 2: Negotiations have facilitated exchanges of information and understanding of the issues in dispute.

Participants in all of EPA's negotiated rulemaking efforts came away with new information (i.e., information they previously did not have and in some cases did not even know existed). EPA was a major beneficiary of this information flow.

In the RCRA, UIC, Farmworker Protection, and Asbestos efforts in particular, many of the participants provided information and insights about 'real world' practices and conditions that helped guide the negotiating committees toward pragmatic regulatory requirements.

In the Asbestos rulemaking, some participants brought in expert consultants who made significant contributions and previously had been unknown to EPA.

Even where consensus has not been achieved, at least some participants thought the negotiations were beneficial in terms of communication. Five people who represented environmental groups in the abortive negotiations on Underground Injection of Hazardous Waste commented: 'We believe that the negotiations have been worthwhile, have increased understanding of the issues and of the various parties' perspectives, and have stimulated communication among all involved' [6]. Regarding the same undertaking, the president of the Chemical Manufacturers Association (CMA) said that CMA's Underground Injection Control Task Group 'believes the process was extremely productive in facilitating an exchange of technical information' [7].

FINDING NO. 3: Developing proposed rules through negotiation has made final rulemaking easier and less costly.

Going from proposed to final rulemaking has been easier and less resource-intensive than it ordinarily is. This was true in the NCP, Pesticides Emergency Exemptions, and Woodstoves NSPS rulemakings. For the Woodstoves NSPS, the Office of Air Quality Planning and Standards will spend about one-half as much time and money as it ordinarily would expect to spend for additional data collection and analysis in order to respond to public comments; this represents a saving of about $150K. Even more significant is the fact that final rulemaking will be completed on schedule, which is not often the case with EPA rulemakings. Based on the Woodstoves NSPS experience, it appears that it is easier to obtain EPA management concurrence in a negotiated rule than in one developed through the conventional process.

FINDING NO. 4: Working relationships developed during negotiations have helped some of the participants work together constructively in other situations.

Two of the participants in the RCRA permit modifications effort--one who represented a public interest law firm and one who represented a chemical company--are working together to find a mutually satisfactory means of enabling the chemical company to undertake an activity that the public interest law firm ordinarily would have opposed.

Participation in the Woodstoves NSPS negotiations has helped Oregon officials improve their relationships with woodstoves manufacturers and thus enabled them to implement the State's woodstoves standards more easily.

The Nonconformance Penalty negotiations helped pave the way for a recent agreement among EPA, environmental groups, and automobile manufacturers on temporarily relaxing particulate emission standards while the manufacturers develop new control technology that will enable them to meet standards more stringent than those originally contemplated.

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[6] Letter dated May 4, 1987 to Michael Cook, Director of EPA's Office of Drinking Water from representatives of the Natural Resources Defense Council, the Kern County Valley Action Network, the Environmental Task Force, the Legal Environmental Assistance Foundation, and Environmental Policy Institute.

[7] Letter dated May 29, 1987 to the EPA Administrator from Robert A. Roland, president of the Chemical Manufacturers Association.

FINDING NO. 5: Experience thus far has reaffirmed the basic premise underlying EPA's pilot-project, i.e., that negotiated rulemaking would be useful in selected situations. Negotiated rulemaking is an appropriate, and potentially effective, means of formulating regulatory policy in some situations. PED's conclusions regarding the circumstances under which negotiated rulemaking works best are presented in the next section. The following 'administrative' factors also affect the frequency with which negotiated rulemaking can be undertaken:

- Negotiated rulemaking is labor-intensive and thus can be burdensome not only for EPA but also for environmental groups, some trade associations, and States. EPA managers who have been the Agency's negotiators have devoted far more time to the negotiations in which they were involved than they ordinarily would spend on a single rulemaking effort. In one case (the NCP negotiations), a division director and two branch chiefs put in significant time.

- Coordination within EPA and with the Office of Management and Budget (OMB) [8] is more critical in negotiated rulemaking than in conventional rulemaking, because the negotiating committee must be confident that the EPA negotiator is speaking for the Federal Government. This coordination process must keep up with (and not delay) negotiations; if Federal agencies delay negotiations in order to coordinate, they can hardly expect other participants to stick to established schedules for negotiations. This far, coordination has not caused any delays.

- Negotiated rulemaking generally will not enable EPA to cut back on pre-proposal data-collection and analysis. EPA cannot depend on other participants to provide all the needed data, especially not on matters such as health and environmental risks. In the Woodstoves NSPS case, however, OAQPS was able to forego some data-collection and analysis, but the resource saving was small. OAQPS still spent more than $1 million gathering and analyzing data before the negotiations began; indeed, the fact that so much work had been done in advance was critical, because it enabled the OAQPS staff to evaluate what participants were saying and to respond to questions about technical and economic issues.

- Negotiated rulemaking heightens people's expectations and therefore is sensitive to 'upsets.' Failure to reach consensus, particularly if negotiations are contentious, may leave participants disappointed and may worsen EPA's relationships with some of them.

- Non-profit groups may be at a greater-than-usual disadvantage in terms of access to expertise. They ordinarily do not have large 'in-house' staffs of technical experts. To get expert assistance in responding to conventional rulemaking proposals, they often send materials to experts who review them in their own homes or offices and send back written comments. Non-profit groups cannot ordinarily afford to hire many experts to accompany them to negotiation meetings (as industry groups can). This disadvantage can be overcome to some extent by allowing non-profit groups to use the resource pool (created for each negotiated rulemaking) to bring appropriate consultants.

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[8] Under Executive Order 12291, OMB has authority to review EPA's rulemaking activities. In conventional rulemaking, OMB review normally takes place after the Agency has developed, but before it has published, proposed or final rules. In negotiated rulemaking, EPA's commitment to basing proposed rules on consensus recommendations from a negotiating committee means that consultation with OMB must take place during negotiations. OMB analysts have been present as observers at many negotiated rulemaking sessions but they usually have not taken part in the discussions. PED saw no indication that OMB's role in review of negotiated rulemaking proposals has differed from its role in conventional rulemaking.

FINDING NO. 6: All affected interests generally have been identified and represented. As a practical matter, affected interests must be organized in order to have an opportunity to participate in negotiations. Within this limitation, PED noted only two instances in which affected interests were not fully represented:

- In the Woodstoves NSPS negotiations, nobody representing truly small woodstove manufacturers was involved. EPA had identified someone to play this role, but his company went out of business before the negotiations began.
- In the Asbestos case, representatives of States' Attorneys-Generals' offices in litigation with asbestos product manufacturers did not become involved in the negotiations until the process was well underway.

FINDING NO. 7: EPA has based its selections of rulemakings for negotiation partly on the existing selection criteria and partly on Program Managers' judgments.

The Agency's first seven choices of rulemakings for negotiation reflect varying degrees of reliance on the selection criteria, tempered in some cases by Program Manager's judgments that negotiations would be worthwhile even though full consensus might not be achieved.

- In all instances, there has been a relatively large number of issues to be resolved, but that has been a real impediment only in the Asbestos negotiations, in which time limitations, as well as a large number of issues, made the process extremely difficult.
- There were action-forcing mechanisms in nearly all cases (e.g., deadlines established to settle litigation in Non-conformance Penalties and Woodstoves NSPS; statutory deadlines, coupled with 'hammer' provisions, in Underground Injection of Hazardous Waste and Asbestos; concern about possible 'gridlock' in review of RCRA permit modifications). Only in the Farmworker Protection case was there no effective action-forcing mechanism; EPA had set a deadline for completing negotiations, but missing the deadline had no unacceptable consequences for any of the participants.

In both the Farmworker Protection and Underground Injection of Hazardous Waste cases, the EPA Program Managers who initiated the negotiations recognized that there were serious obstacles to achieving full consensus. In both instances, however, they believed there were good reasons to proceed, including the possibility of reaching consensus and/or bringing the parties closer together on some issues and the opportunity to learn more about 'real world' conditions relevant to the rulemaking. Similarly, in the Asbestos case, the Program Managers recognized the risk that consensus would not be reached, particularly because of the limited time available and the large number of issues, but they made a judgment that negotiations would nevertheless be worthwhile, since the process would involve many of the same groups that had worked together during Congressional consideration of the underlying legislation.

## Section 6. Questions not answered by this study

PED could not answer two of the questions that have been raised about EPA's negotiated rulemaking activities:

- Whether it results in a net saving of EPA resources could not be determined, and, perhaps, can never be determined, because the Agency does not keep records of its resource utilization separately for each rulemaking effort; EPA generally has no need for such detailed data. Based on this study, it appears that pre-proposal costs are reduced only slightly, if at all. If, however, final rulemaking is easier, there may be some savings. If litigation is avoided, and if affected industries' acceptance of the rulemaking produces a high degree of voluntary compliance, all parties may reap substantial savings.

- Whether the risk of litigation is reduced will be difficult to determine until EPA has completed final rulemaking in several more cases. There has been no litigation dealing with the first two negotiated rulemaking efforts (and litigation on the Woodstoves NSPS seems unlikely), but it obviously is impossible to predict what will happen with respect to those cases in which rulemaking has yet to be completed. Even where there is litigation, it seems possible that negotiations will have reduced the number of issues to be decided.

## Section 7. General observations--Pro and con

In addition to answering PED's questions about the seven negotiating rulemaking efforts in which they were involved, many interviewees offered some general observations about the negotiated rulemaking process.

### EPA managers

EPA managers who have served as the Agency's negotiators think negotiated rulemaking is worthwhile. Even those who were involved in negotiations in which full consensus was not achieved believe the Agency obtained valuable information and brought opposing 'sides' closer together.

- They said they would be willing to do it again--given appropriate rulemaking situations--provided that their personal time investment can be limited.

- Office Directors, in particular, said they cannot routinely devote so much of their time to a single rulemaking activity, but they recognized the importance of personal involvement at the outset and accessibility throughout the process, especially when major issues are being addressed.

### Other participants

Many of the non-EPA participants indicated that they like negotiated rulemaking because they believe it provides unique opportunities to have direct dialogue with EPA decision-makers [9], to hear other parties' concerns and explain their own, and to present data and arguments before an EPA proposal polarizes the interested parties.

On the other hand, many non-EPA participants have reservations about negotiated rulemaking.

- Pressure to reach consensus makes many people uncomfortable. Some interviewees expressed concern that negotiations could result in 'weaker' regulations. Others took the opposite view--that negotiations may force regulated industries to make concessions and accept restrictions they would resist in conventional rulemaking. [10]

- Some interviewees took the position that 'anything' could be negotiated, but most raised questions about the appropriateness of negotiated rulemaking in certain situations (e.g., those involving 'life and death' issues [10]).

- Many interviewees voiced at least some concern about the time required for participation in negotiated rulemaking. An official of one trade association noted that even though he works for a large organization, he is the only person working full-time on environmental issues and therefore cannot afford to become involved very often in negotiated rulemaking. Staff members of environmental groups and other organizations have similar concerns.

- Several interviewees wondered what role OMB plays in negotiated rulemaking and how EPA interacts with OMB; people who raised such questions usually added that they assumed (correctly) that EPA-OMB coordination was taking place even though it was not visible to them.

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[9] There is an apparent inconsistency between top managers' desire to limit the time they spend at the negotiating table and other negotiators' preference for talking directly with EPA decision-makers. Subordinate officials may be able to substitute successfully for top managers if the subordinates are, in fact, involved in dealing with the issues being discussed and are perceived (by other negotiators) as having the EPA negotiator's confidence.

[10] In an article that appeared August 3, 1987, in Legal Times, EPA's use of negotiated rulemaking was attacked on the ground that the Agency uses this approach to 'strike deals' among the interested parties without regard to statutory requirements. The authors, Rena Steinzor and Scott Strauss, were not among the people PED interviewed. Mr. Strauss was a participant in the Asbestos negotiations. None of the people PED interviewed expressed such views.

[10] This characterization came not from an interview but from a memorandum prepared by David Doniger of the Natural Resources Defense Council and dated November 15, 1983, in which he asked staff members of other environmental groups to suggest topics appropriate for negotiated rulemaking.

## Section 8: Conclusions

EPA's experience thus far suggests that negotiated rulemaking will work best (i.e., most likely result in consensus on proposed rules) when all or most of the following conditions exist:

- Rulemaking involves 'second-tier' rules affecting program implementation--rather than rules establishing program structure. The RCRA Permit Modification and Non-conformance Penalty rules are excellent examples of 'second-tier' rules.

- Rulemaking does not involve any extremely controversial national policy or complex multi-media issues. How to define 'no migration' from hazardous waste injection wells was just such an issue. Rules setting national standards often will involve extremely controversial issues. The Woodstoves NSPS rulemaking did not; in addition, it related only to air quality.

- The principal parties have (or can reasonably be expected to agree upon) common goals. For example, participants in the RCRA rulemaking were united in wanting to reform the process for review of permit modifications; participants in the Woodstoves NSPS rulemaking all supported the adoption of national standards; and participants in the Non-conformance Penalty rulemaking were all interested in promoting compliance (rather than in making non-compliance cheap).

- The policy implications of the issues to be resolved are more-or-less limited programatically, i.e., the rulemaking will not establish precedents that will be binding in program areas not encompassed by the negotiations. This was a problem in the case of Underground Injection of Hazardous Wastes.

- Where complex scientific and technical issues must be resolved, the necessary data should be readily available. While negotiators may bring some relevant data to the table, negotiated rulemaking is certainly not the only way, nor is it necessarily the best way, to obtain data, especially detailed scientific and technical data on the nature and extent of health and environmental risk and on the technological and economic feasibility of alternative solutions.

- Ongoing litigation should be carefully analyzed to ensure that it will not affect participants' willingness or ability to engage in genuine give-and-take. In the Asbestos rulemaking, representatives of the parties involved in litigation could not accept an outcome that would prejudice their case.

- The time available for negotiations is adequate. PED has concluded that the length of intervals between negotiating meetings is the best measure of the adequacy of time for negotiations. It must be long enough to allow participants to digest and reflect on what has taken place, to talk to one another informally (if they wish), to consult the groups they represent, and to prepare for upcoming meetings. In most of the negotiated rulemakings EPA has undertaken, this interval generally has been four weeks, which has been adequate. In the Asbestos rulemaking, meetings were held every two of three weeks, in an effort to meet a statutory deadline; this haste may have been a factor contributing to the ambiguous outcome of the negotiations.

Whether 'acceptable risk' issues are involved is another factor to be considered when EPA is deciding whether to undertake negotiated rulemaking. The more important it will be to choose an 'acceptable risk' level, the more difficult it will be to reach consensus; indeed, where 'acceptable risk' is a central issue, many interested parties may be unwilling to negotiate.

## Section 9: Recommendations

Negotiation is appropriate and potentially fruitful in some of EPA's rulemaking efforts.

Deciding when negotiated rulemaking would be particularly useful is obviously the key. Toward this end, additional criteria based on PED's conclusions as to 'Where it works best' could be helpful. But EPA cannot depend solely on selection criteria. Even where all or most criteria are met, consensus will not necessarily be achieved. EPA's top managers still will have to make judgment calls about the selection of candidates for negotiated rulemaking.

Because negotiated rulemaking is a highly visible process, and because an agreement (in advance of negotiations) to base a rulemaking proposal on the consensus achieved by a negotiating committee is binding on the Agency, either the Administrator or Deputy Administrator should continue to be involved in decisions to negotiate. An elaborate decision-making process is not necessary, but the Administrator or Deputy Administrator should at least be made aware of:

- The extent to which the rulemaking in question meets whatever selection criteria the Agency is using
- The risk of not achieving the objectives of any negotiated rulemaking effort
- Whether any alternative procedures would be more likely to meet the objectives
- The likely consequences of failure to reach consensus
- Whether satisfactory arrangements have been made for coordination within EPA and with other Federal agencies

In short, negotiated rulemaking is likely to be worthwhile where the conditions for success seem to exist and where EPA managers and other interested parties are able and willing to devote the necessary time and energy.

ATTACHMENT #2

# REGULATORY NEGOTIATION AND OTHER CONSENSUAL ACTIVITIES
# AT
# THE ENVIRONMENTAL PROTECTION AGENCY

## BACKGROUND

EPA's Traditional Approach to Regulatory Development: EPA has approximately two hundred to two hundred and fifty regulations under development at any given time. Over 95% of these are statutorily required. These are usually developed using the informal notice-and-comment requirements of the Administrative Procedures Act. Using this approach, EPA gathers facts, requests information, fashions a regulatory strategy, and proposes a rule. EPA then solicits public comment and often conducts public hearings. Most of EPA's proposed rules engender large numbers of in-depth comments. After reviewing the comments received, the Agency promulgates a final rule. Approximately 80% of these final rules are challenged in court.

Why We Began the Project: We felt there must be a better way to proceed -- for at least some of the large number of regulations we have under development at any time. In 1983, EPA began a demonstration project to attempt to develop two proposed rules by face-to-face negotiations among affected parties. The project's purpose was to investigate the value of developing regulations by negotiation, the types of regulations which were most appropriate for this process, and the procedures and circumstances which best fostered successful negotiations.

Based on the success of the first two negotiations, described in more detail below, we continued with additional negotiations. We believed at the outset, and believe even more strongly now, that Regulatory Negotiation offers an innovative opportunity to use our time and resources and those of interested parties more effectively, involve the public more fully and openly, produce better regulations, and reduce litigation, uncertainty, and delay.

What We've Done So Far: To date, we have conducted seven negotiations. At any given time, we are either in the process of conducting negotiations, evaluating additional candidates, or both.

Top EPA management quickly realized that the principles of consultation, collaboration, negotiation, and consensus were workable ones which were not limited exclusively to the rulemaking arena. Now, in all Agency activities, we attempt to expand the degree to which we consult with representatives from industry, environmental organizations, state and local governments, and other interests.

Our activities in support of greater consultation have included numerous trainings in negotiation and other consensual approaches. We have also helped structure a variety of public meetings so EPA can better understand the concerns of those affected by our actions.

## HOW REGULATORY NEGOTIATION WORKS

Overview: Regulatory Negotiation brings together a balanced mix of parties and interests, including EPA, at the pre-proposal stage. Negotiations are conducted by federally-chartered advisory committees, with the goal of reaching a consensus on which to base a Notice of Proposed Rulemaking. EPA's promise is to use any consensus reached that is within its statutory authority as the basis of the proposal. Once a regulation is proposed by EPA, all procedural requirements and safeguards of the Administrative Procedures Act and other relevant statutes apply.

Participation: A senior EPA official selected by the office responsible for developing the rule acts as EPA's chief negotiator. Individuals representing definable interests among the regulated community, environmental groups, enforcement officials, states, and other affected stakeholders negotiate on behalf of their constituencies. The Regulatory Negotiation project staff, part of the EPA office which manages the regulatory development process and which is organizationally independent of the program office, provides the necessary administrative, logistic and other support.

Convening Phase: The convening phase covers the important work of determining whether an item is appropriate for negotiation. It has two steps. In step one, we ensure that the item meets EPA's threshold evaluation criteria. These selection criteria (attached) were developed after a review of the literature on negotiating environmental disputes. We also select a convenor to identify and make initial contact with potential participants and, after these contacts, to recommend whether or not the item appears to be a likely candidate. If the convenor and Regulatory Negotiation staff believe a sufficient balance and mix of parties and interests will negotiate in good faith, on an identified set of issues, within a designated time period, and under a generally understood set of ground rules, we proceed to step two.

In step two, the convenor requests firm commitments from individual parties to proceed, and their assurance that they are able to speak for their organization/constituency. If these commitments are received, EPA publishes a Federal Register notice announcing its intent to negotiate the item. This notice announces an open organizational meeting with potential participants to review the scope, timing and procedural aspects of the negotiation, and to confirm the group's commitment to proceed. The notice also invites public comment on any aspect of the negotiation plan. If the parties at the organizational meeting want to proceed, and no adverse public comments are received which cause EPA to reconsider, we charter a committee under the Federal Advisory Committee Act (FACA), and commence negotiations.

For the first six negotiations, we engaged contractors to act as convenors. For the seventh negotiation on asbestos, we used co-convenors. One was a contractor, and the other was from EPA's regulatory negotiation staff.

Pre-negotiation Orientation/Training: On the day before the first formal negotiation session, we provide a full day of orientation and training in negotiation. The day gives the participants a common skill base, language, and set of assumptions, to apply to the negotiation they are about to begin. Participants and facilitators alike have reported this is extremely valuable in helping the committee achieve consensus.

Groundrules or Protocols of Operation: We prepare draft groundrules or protocols for each negotiation committee's consideration, reformulation, and approval at the first meeting. These drafts reflect the features which earlier groups have found useful. By approving the protocols, the parties make the negotiation their own from the outset, and start with a positive experience of achieving consensus.

Facilitation: A neutral facilitator chairs the negotiations and keeps the process moving smoothly. The facilitator's job is to keep the parties talking, listening and moving toward consensus. For the first negotiation, we engaged a contractor to act as facilitator. For the second, we used an EPA official who was organizationally independent from the program office accountable for the rule under negotiation. Our third and fourth were co-facilitated by a contractor and an Agency official independent of the program office. Contractors facilitated the fifth, sixth, and seventh negotiations.

## NEGOTIATED RULEMAKINGS TO DATE

Nonconformance Penalties: After extensive analysis, we selected Nonconformance Penalties as our first negotiation item. These penalties are designed to provide temporary relief for manufacturers of heavy-duty trucks or vehicles who initially cannot meet EPA emissions standards, which are based on the most advanced technology. Manufacturers are allowed to sell nonconforming engines, provided they pay a penalty. The penalty is intended to cost nonconforming manufacturers as much as compliance would have cost the first year, and to create an incentive for future compliance by increasing the penalty in subsequent years.

In April 1984, EPA held an informal organizational meeting which nearly every potential party attended. In accordance with the process above, EPA then formally announced the establishment of the Committee. Members included foreign and domestic manufacturers, environmental organizations, state pollution control officials, trade associations, and EPA.

The Committee held its first meeting on June 14, 1984, and allotted four months to complete the negotiations. The group reached consensus on the core issues within that time, and EPA published a proposal in the March 6, 1985 Federal Register. Only thirteen comments were received, all from participants, all supporting the consensus. EPA promulgated final regulations on August 30, 1985. No litigation has ensued.

Emergency Pesticide Exemptions: Section 18 of FIFRA allows the Administrator to exempt federal or state agencies from its provisions if s/he determines that emergency conditions exist requiring such action. EPA had issued implementing regulations in 1973. Internal and external analysis indicated they were ripe for improvement.

In August 1984, EPA formed an Advisory Committee to negotiate new Emergency Pesticide Exemption requirements. Membership included representatives of environmental organizations, users, state agricultural and health departments, trade associations, the U.S. Department of Agriculture, and EPA. The Committee first met at the end of September and designated four months for its negotiations.

Within the time allotted, the Committee reached full consensus on the exact wording of text and preamble of the Notice of Proposed Rulemaking. The proposal appeared in the April 8, 1985 Federal Register. EPA received nineteen comments, three from participants supporting the proposal, the others raising relatively minor points of interpretation or concern. EPA promulgated final regulations on January 15, 1986. No litigation has ensued.

Farmworker Protection Standards: EPA decided to revise its 1974 standards to reflect the latest data on worker hazards, innovations in available protective clothing, and to improve overall compliance.

After extensive discussions with potential parties, EPA chartered a Negotiating Committee, which first met in November 1985. Membership included a mix of grower, farmworker, state, and enforcement interests.

These negotiations took a different path than the first two. After four months of work, members representing a major interest group announced they would not return to the negotiations. Under the Committee's ground rules, any party could leave at any time without prejudice. Consistent with these rules, EPA acted to balance the rights of those who chose to leave with those wanting to continue.

EPA investigated all options to bring those who left back to the negotiation, and continued to treat them as full participants, always entitled to return. The remaining parties agreed that, if the absent group did not return, they would continue to share information among themselves and develop a draft rule striving to balance all interests, without purporting to represent a "consensus" of all original members, and without EPA being bound by the negotiated draft. EPA expects to publish a Notice of Proposed Rulemaking in the Federal Register by the end of 1987.

Woodburning Stoves: Air emissions from woodstoves pose a significant and growing problem. New control technologies greatly reduce emissions and are now commercially available. On August 2, 1985, EPA announced plans to develop New Source Performance Standards for Residential Wood Combustion Units.

In February 1986, EPA chartered an Advisory Committee to negotiate these standards. Membership included a balanced mix of woodstove and catalyst manufacturers, public interest groups, and state officials.

The first full Committee meeting was held in March 1986, and the Committee completed negotiations as scheduled on August 21, 1986, with agreement on the core issues. It appointed a drafting workgroup to fashion preamble and regulatory language. The Committee as a whole ratified the workgroup's proposed regulatory language, and EPA published the proposed rule on February 18, 1987. The public comment period closed on April 20, 1987. EPA received over fifty comments and plans to publish the final rule in early 1988.

RCRA Minor Permit Modifications: Current EPA regulations govern when and how hazardous waste management facilities may modify Resource Conservation and Recovery Act (RCRA) permits. The regulations establish two modification categories -- major and minor. In recent years, EPA, permittees, and members of the public have recognized the need to revise these procedures to develop a more flexible and workable permit modification system.

In August 1986, EPA chartered an Advisory Committee to negotiate on proposed changes to the permitting procedures for minor modifications. Membership included representatives of public interest groups, trade associations, industry, States, and

EPA. The Committee held its first meeting on September 10, 1986, and completed its work on February 23, 1987. Twenty of the twenty-one members ratified the document the group fashioned. The Notice of Proposed Rulemaking was published in the Federal Register on September 23, 1987.

Underground Injection: The Hazardous and Solid Waste Amendments of 1984 (HSWA) contain provisions curtailing nearly all aspects of hazardous waste injection beyond specified dates, unless EPA finds such disposal protects human health and the environment. EPA estimates that 60% of the hazardous wastes disposed on land are injected.

In September 1986, EPA chartered an Advisory Committee to negotiate these standards. Membership included representatives of public interest groups, trade associations, industry, States, and EPA. On March 31, 1987, after seven months of meeting, the negotiation ended. Though the group reached substantial agreement on many points, no across-the-board consensus was achieved. EPA published the proposed rule in the Federal Register on August 27, 1987. The public comment period closed on October 27, 1987. EPA received approximately 30 comments and plans to publish the final rule in 1988.

Asbestos in Schools: On October 22, 1986, Congress enacted the Asbestos Hazard Emergency Response Act (AHERA), directing EPA to regulate asbestos problems in public and private schools, and establishing a deadline of April 20, 1987, for proposing regulations. These regulations had to address inspections for asbestos-containing materials (ACM), response actions, periodic surveillance programs, operations and maintenance programs, asbestos management plans, and transportation and disposal of waste ACM.

In February 1987, EPA chartered an Advisory Committee. Membership included representatives of education groups, school service employees, asbestos product manufacturers, asbestos abatement workers, contractors, designers, industrial hygienists, school districts, public interest groups, States, and EPA.

The Committee held its first meeting on February 5, 1987. By April 3, 1987, under a very short deadline, members representing 20 of the 24 interests on the Committee agreed to use regulatory language covering most issues before the Committee as a basis for the proposed rulemaking. The proposed regulation was signed on schedule, and appeared in the Federal Register on April 30, 1987. EPA received over 130 comments. EPA published the final rule in the Federal Register on October 30, 1987.

### Consensus Activities to Date:

EPA expanded the use of consensual activities to better include in Agency decision-making the viewpoints of representatives from industry, environmental organizations, states, local governments, and other affected interests. Thus far, EPA has engaged in policy dialogues, conducted facilitated public meetings, sponsored studies, workshops, and strategic planning sessions, and hosted trainings in consensual decision-making for personnel across the Agency.

The Regulatory Negotiation Project staff helps coordinate these consensual activities. It does so by providing the needed support directly, drawing on available in-house expertise, or locating and helping to manage appropriate outside experts. Suggestions to consider negotiating or other consensual approaches can orginate from within the Agency or from outside parties.

## WHAT WE HAVE LEARNED

From the first seven negotiations and our consensual activities we have learned several things:

- Regulatory negotiations can succeed with an inside or an outside facilitator and/or convenor. For future negotiations, the nature of the rule, and the needs of the group, should dictate which combination of inside, outside, or co-facilitators/convenors will be most useful.

- Selecting an appropriate item is our most critical step; and success is most likely when the item is "ripe", the parties and issues identifiable, and the parties willing to negotiate in good faith.

- The process can work, even when the committee does not reach full consensus.

- Negotiating committees can fashion and implement their own groundrules in an equitable way.

- The process can balance the needs of parties who feel they must leave with those parties who remain and wish to go forward.

- Although negotiations have been somewhat more demanding of staff time than first anticipated, participants (including EPA) have reported they feel the time and energy invested were worthwhile. They have pointed to the quality and comprehensiveness of the proposals, and to the enhanced communication among participants which they said would produce positive benefits in future interactions.

- While regulatory negotiation is not a panacea, it appears to hold considerable promise as an efficient and effective way to develop select EPA regulations.
- Consensus, collaboration, and negotiation have considerable utility as management tools in the non-regulatory as well as the regulatory context.

## WHAT'S NEXT

Using negotiation, consultation and consensual approaches to develop regulatory and other items will continue as a major Agency management theme.

We will screen future regulatory and other items to ensure that we capitalize on any opportunities to improve communication with those affected by our actions, and to do a more effective job of fashioning better regulations and policies. We will conduct more negotiations and provide additional consensual services, including training.

Other organizations and individuals are increasingly interested in the process. A number of federal agencies have initiated or will be initiating their own negotiations, and a number of States have shown keen interest in starting projects of their own. They increasingly call on the project staff to help structure and manage such projects. We have and will continue to share what we have learned with these groups and to provide support.

For More Information: If you have questions, or want more information, please contact:

Chris Kirtz, Director
Regulatory Negotiation Project
U.S.E.P.A., 401 M Street, S.W. (PM-223)
Washington, D.C. 20460 (202) 382-7565

Attachment

## SELECTION CRITERIA

Because negotiation is not suitable for every situation, it is important to screen potential rulemakings to identify instances where this approach has a high probability of successful use. We use the following criteria to screen and select appropriate items. These criteria were developed after a thorough review of the considerable literature on the use of negotiation to resolve a wide range of environmental disputes.

### Criteria for the Item

- o The proposal should require the resolution of a limited number of interdependent or related issues, none of which involve fundamental questions of value. There must be a sufficiently well-developed factual base to permit meaningful discussion and resolution of the issues. There should be several ways in which the issues can be resolved.
- o To promote timely resolution and to limit a participant's ability to gain from delay, there should be a legislative or judicially imposed deadline or some other mechanism forcing publication of a rule in the near term, i.e., 8 to 12 months.
- o Some or all of the parties should have common positions on one or more of the issues to be resolved which might serve as a basis for agreement during the course of negotiations.
- o The costs and benefits should be narrowly concentrated on a few identifiable entities

### Criteria for the Participants

- o Those participants interested in or affected by the outcome of the development process should be readily identifiable and relatively few in number. Participants should be able to accurately represent and reflect the interests of their constituencies.
- o The parties should be in good faith about wanting to participate in negotiations. They should feel themselves as likely, if not more likely, to achieve their overall goals using negotiation instead of existing alternatives.
- o The parties should view themselves as having an ongoing relationship with the Agency beyond the item under consideration.

ATTACHMENT #3

COSTS OF REGULATORY NEGOTIATIONS TO DATE

| NEGOTIATION | THIRD PARTY NEUTRAL SUPPORT |  |  | RESOURCE POOL SUPPORT |  | TOTAL | OVERALL TOTAL | OPPE | PROGRAM OFFICE |
|---|---|---|---|---|---|---|---|---|---|
|  | CONVENING | FACILITATION | ANALYSIS | TRAVEL & PER DIEM | CONSULTANTS |  |  |  |  |
| ASBESTOS | $8,000.00 | $36,200.00 |  | $16,139.00 | $9,112.00 | $25,251.00 | $69,451.00 | $9,451.00 | $60,000.00 |
| UIC | $22,232.00 | $69,558.00 |  | $35,903.00 | $4,457.00 | $40,360.00 | $132,150.00 | $82,150.00 | $50,000.00 |
| RCRA | $22,765.00 | $56,908.00 |  | $8,895.00 |  | $8,895.00 | $88,568.00 | $65,568.00 | $23,000.00 |
| WBS | $5,970.00 | $21,792.00 | $6,500.00 | $20,763.00 | $5,946.00 | $26,709.00 | $60,971.00 | $60,971.00 |  |
| FWP | $30,000.00 | $34,605.00 |  | $43,407.00 | $5,899.00 | $49,306.00 | $113,911.00 | $103,911.00 | $10,000.00 |
| SEC. 18 | $23,500.00 | $37,500.00 | $5,000.00 | $25,306.00 |  | $25,306.00 | $91,306.00 | $91,306.00 |  |
| NCP | $18,500.00 | $47,000.00 | $5,000.00 | $20,048.00 | $12,500.00 | $32,548.00 | $103,048.00 | $103,048.00 |  |
| AVERAGE | $18,709.57 | $43,366.14 | $2,357.14 | $24,351.57 | $5,416.29 | $29,767.86 | $94,200.71 | $73,772.14 | $20,428.57 |

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUN 27 1988

OFFICE OF
POLICY, PLANNING AND EVALUATION

Honorable Jim Sasser
U.S. Senate
Washington, D.C. 20510

Dear Senator Sasser:

Thank you for your interest in negotiated rulemaking. This letter is in response to your questions regarding legislative intervention.

You asked if some sort of legislative intervention is necessary as an incentive to use negotiation as a process for rulemaking. As you know, EPA has had a significant amount of experience in negotiated rulemaking and is a strong supporter of that process. Our experience tells us that we must select appropriate candidates for negotiation very carefully, and tailor each process to fit unique needs. We would welcome incentives to encourage the use of negotiation in appropriate circumstances. But it is difficult to say whether legislative intervention is the "necessary" or best way to bring this about.

You further asked whether any such legislation should be limited to procedures, or whether it should go further, to detail the relationship between "reg-neg" and other approaches and applicable laws. This is a difficult question to answer in the abstract. On the one hand, it might be helpful to go beyond strictly procedural matters to define or clarify complex issues, such as how to handle Federal Advisory Committee Act requirements in a negotiation process. On the other hand, one would have to be very careful that any provisions, including procedural ones, did not hamper the flexibility so essential to the dynamic negotiation process. My concern is that a bill, no matter how well intentioned, might establish procedures or other requirements that would prove cumbersome in practice. The result would then be to impede rather than to enhance the use of negotiated rulemaking. EPA's experience has demonstrated to us the great value of flexibility in letting the parties have a hand in designing the procedures for any particular negotiation.

Thank you for the opportunity to give my views on these issues. I would be happy to discuss these matters in more detail or to respond to any other questions you might have.

Sincerely yours,

Thomas E. Kelly, Director
Office of Standards and
Regulations

# TESTIMONY OF PHILIP J. HARTER
# BEFORE THE
# SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
# CONCERNING
# S. 1504, THE "NEGOTIATED RULE MAKING ACT"

My name is Philip J. Harter. I am a lawyer here in Washington. I have held several government positions responsible for the administration of regulatory programs, and I teach administrative law at the University of Maryland's School of Public Affairs. I am a member of the Standing Committee on Dispute Resolution of the American Bar Association, am chair of the Committee on Dispute Resolution of the ABA's Section of Administrative Law, and was formerly on the Council of the Section. I served as the consultant to the Administrative Conference of the United States with respect to its Recommendation 82-4, "Procedures for Negotiating Proposed Regulations." Indeed, many of these remarks are based on the report I prepared for ACUS.[1] I have served as the convenor or mediator for a number of regulatory negotiations and as a consultant to other agencies in the organization and conduct of their negotiations. Thus, I approach questions of dispute resolution and the procedures by which regulatory agencies function from both a practical, hands-on perspective and from an academic, theoretical viewpoint.

By way of general introduction, I am delighted to report that what I once thought would likely be viewed as a radical proposal has now been widely accepted and has demonstrated its power for addressing difficult, complex regulatory issues. As S. 1504 itself recognizes, agencies are authorized under current law to use negotiated rulemaking as embodied in the ACUS recommendation. The bill does an admirable job of codifying the current process and, by setting out the authorization in concrete terms in the statute book, its enactment would encourage agencies to use this proven technique even more as a means of addressing difficult regulatory problems.

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[1] Harter, Negotiating Regulations: A Cure for Malaise, 71 Geo. L. J. 1 (1982).

## I

## BACKGROUND: SHORTCOMINGS OF HYBRID RULEMAKING APPROACH

Rulemaking, it is often said, is the "legislative" side of administrative decision making. As the very definition of "rule" in the Administrative Procedure Act makes clear, it is the means by which agencies establish policy. These decisions can have far reaching, significant effects and involve the essence of political choices that must reconcile a host of competing needs and values. For example, what is the appropriate trade-off between costs and safety; between mandated requirements and individual choice; between how clean the air or water should be as compared to the costs of achieving them; between the needs of low income tenants for protection and services and the need to spur investment in low income housing by ensuring sufficient rents; and so on. These decisions are clearly influenced by and build on a factual basis, but only rarely are they actually determined factually. Nor is there any one purely rational or "correct" answer that can be calculated if only we supply sufficient analysis. Similarly, statutes rarely provide precise guidance as to how to resolve the issues and leave a wide range of discretion in the agency. In short, the agency retains considerable discretion, the exercise of which is quintessentially a legislative function.

Yet, the traditional procedures used for developing rules have not paid particular attention to the way a legislature operates. Rather, they have been a combination, varying over time and circumstance, of administrative, hierarchal decision making and a judicial-type process. These approaches have attributes that are important in some rulemaking situations, but they are unable to supply the primary benefit of a legislative process: the means of reconciling varying interests in a way consistent with other national goals, and a means of bringing direct, firsthand information and values to bear on solving a complex problem. As a result, the process does not always fit the need.

Because the primary means of swaying the agency's decision in a typical "hybrid" rulemaking proceeding is through the record, the process becomes bitterly adversarial. That is frequently dysfunctional both for developing the underlying information and for reaching a political accommodation. Because the parties lack the ability to actually participate in the decision, they not infrequently attempt to narrow the agency's discretion by pushing the scientific basis or other facts beyond that which it can reasonably sustain. By asserting that the facts "prove" their case, the parties seek to constrain the range of choice. Thus, the facts become a surrogate for a political process, and they are often corrupted as a result.

Moreover, the parties tend to take extreme positions without recognizing the important subtleties and doubts over the data and results; they withhold information for fear it will be misused or misinterpreted; they address the decisionmaker and not each other, so the submittals pass each other without adequate consideration of the legitimate points that are raised; they fail to address the respective needs even though they could be accommodated without loss; they hit each point with equal vigor so the decisionmaker often lacks an ability to tell what is important to the submitter. There is no opportunity for an iterated dialogue in which positions are clarified and adapted to the needs; the forest is lost by examining minute parts of trees so the decisionmaker will usually lack a "feel" for the issues and information involved.

In theory, a process modeled more on legislative than on executive or judicial decision making would address many of these shortcomings. And, indeed, its use has proved it to be a powerful tool. But, parties will not come together, be reasonable, and agree on an optimal solution simply because the process is dubbed nonadversarial. Rather, a process that relies on discussions and consensus must be recognized as a means of channelling or reconciling conflict, not avoiding it.

This means the parties must view it as in their interest to participate in the process, in that they believe they would be better off using this method as opposed to some other for developing the rule. Moreover, because the process we are considering would be used by an agency which is not itself sovereign, the result must be within the authority delegated by Congress.

## II

## A LEGISLATIVE PROCESS FOR RULEMAKING

Using direct negotiations among the interested parties has proven particularly beneficial for rules that are relatively complex, have a significant factual basis but are not "driven" by the facts, and have -- for one reason or another -- become controversial or politicized. The process enables the parties not only to develop a rule but to reconcile the political tussles surrounding the rule as well. Without the ability to channel and resolve those political questions, rules are often held hostage for years if not decades while other means are used to address the underlying concerns that are never quite on the surface of a typical proceeding.

It may be too expensive and time consuming to use for many routine rules, however, and rules that will necessarily establish major precedents as to how an entire regulatory program will function will likely require the formality of the hybrid process followed by the ultimately authoritative pronouncement of a court.

General Criteria for Negotiating Rules. Both the theory and practice of regulatory negotiation indicate that developing a regulation by a consensus of those affected will likely be feasible and attractive if the following conditions are met:

- **A limited number of interests will be significantly affected, and they are such that individuals can be selected to represent them.** A rule of thumb is that no more than twenty five people would have to participate at any one time, although each interest may be represented by a caucus or "team." Discussions can become unwieldy if there are many more than that. While this may seem like a small number and hence a significant limitation, only a few parties play the significant roles in most major rulemakings. The process would not be appropriate, however, if a major interest is not sufficiently organized so that a representative can be selected.

- **The issues are known and ripe for decision.** The parties would not likely grapple with issues that are only emerging and are neither well defined nor imminent for decision. Thus, the matter must be sufficiently developed so the participants can focus on relatively well crystallized issues: it is on the action agenda.

- **No party will have to compromise a fundamental value.** Negotiations are not appropriate if a party would be required to violate something it holds as a fundamental precept. While the issues presented for agreement can be major and important, if they rise to the level of **faith**, agreement is unlikely. Such issues need to be resolved in some other forum.

- **The rule involves diverse issues.** The parties will likely not agree if only one issue is presented. The advantage of negotiations is a type of "Jack Sprat" rulemaking -- what may be critical to one party may well not be so important to another. Thus, the parties can rank the issues according to their respective needs and priorities and thereby attempt to reach an accommodation. Doing so requires that the rule in question raise a range of issues or approaches.

- **The outcome is genuinely in doubt.** If a party has the raw power -- through political influence, a commanding position on the relevant facts, or bargaining strength -- to dictate the results of the proceeding, it would likely be inappropriate to use a consensus process. Those without direct power would generally need the formal structure of the rulemaking process to protect their interests or to alter the relative power balance. If, however, there is sufficient countervailing power so that no party can achieve its goal without incurring a sanction it views as unacceptable, the process would be a suitable way of reconciling those positions and avoiding the impasse.

- **The parties view it as in their interest to use the process.** Negotiation is a voluntary process parties engage in because they believe they will be able to achieve more by doing so as opposed to using some other means to pursue their desires. A party that feels forced to the table may go through the motions of participation, but it will likely not be a full, creative participant and may take actions subsequently to attempt to scuttle the product of any discussions.

- **The agency is willing to use the process and participate in it.** Experience shows rather dramatically that any agency can find creative ways to sabotage a process it does not like. Thus, even if the private groups met and developed a recommendation, the agency may well reject it as a result of the "not invented here" syndrome or a concern that the "proper" balance was not struck. Thus, the agency must believe the direct discussions are an appropriate way to develop the proposal. Moreover, a senior official, generally the one who would be responsible for developing a draft rule inside the agency, should participate as a full member of the negotiations so that the agency's views can be incorporated in the deliberations and the agency feels a part of it.

Assembling the Negotiators. The procedures by which negotiations are actually put together and conducted have varied somewhat, but the basic model has a neutral convenor/mediator playing a central role. The idea to use regulatory negotiation might originate inside the agency or, as has happened several times recently, an affected party might urge the agency to use it. Once the agency decides to explore the potential for using regulatory negotiation to develop its rule, it retains an independent "convenor"[2] to make a more formal "feasibility study."

The convenor identifies the interests that would be substantially affected by the subject matter of the regulation by talking with agency officials and to people with a readily identifiable interest in the outcome, and by doing some independent digging. By talking with representatives of those parties, the convenor attempts to develop an appreciation of just what parties would be affected by the rule, what parties would need to participate directly in the negotiations, and what parties might join in coalitions to be represented by others; what issues must be confronted in the negotiations; and, whether the conditions favorable to direct discussions are met.

If it appears that negotiating is an appropriate course of action, the agency publishes a notice in the Federal Register, and in publications likely to reach the appropriate audience, announcing that it is contemplating using negotiated rulemaking to draft the rule and listing both the issues involved and the parties that were identified by the initial inquiry. The notice also solicits participation by any interest that feels it would be substantially interested in the outcome and yet is not adequately represented by those who are already participating. If, on the basis of the notice and the convening effort, the agency decides to use direct, face-to-face negotiations to develop the rule, it empanels the representatives of those interests into a negotiating committee under the auspices of the Federal Advisory Committee Act.

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[2] The convenor is generally independent to ensure that all appropriate parties are identified and consulted, even those which are considerably hostile to the agency. The independence also permits the parties which are consulted to be candid concerning the issues, the parties, and the potential of the negotiations. The convenor also usually explores with the parties a tentative set of groundrules by which a negotiating committee would operate; understanding the procedures helps the party decide whether it is in its interest to participate and to make them more comfortable with the process at its early stage.

Role of a Mediator. Since the parties will frequently not have worked together before in any systematic way and because the issues involved are likely to be difficult, having a mediator assist the parties in their negotiations has proven beneficial. Since the convenor develops an understanding of the issues and a rapport with the parties, it is usually more efficient to have that person flip over and also serve as the mediator. The mediator needs to be in control of his or her time and must at times act quite independently, and at all times with the confidence of the parties (the mediator serves at the will of the committee). It is therefore also recommended that the mediator be truly free of any of the parties and without conflicting duties.

The mediator serves as a traffic cop during the negotiations, helps the parties define their own basic needs and interests; helps develop creative solutions that reconcile the varying needs; helps develop enough trust and common ground to make it "safe" for the parties to negotiate directly with one another; helps frame the discussions; serves as an "agent of reality" to help deflate the more extravagant views; and generally works to enhance communication.

The Negotiations. The committee meetings are announced in advance and are open to the public; members of the trade press usually attend as do other interested people. The committee's first order of business is to define the protocols or groundrules by which the committee will operate. It will then decide what the relevant issues are and cluster them into related topics that serve as an agenda for future meetings. It next decides what information it reasonably needs to develop a recommended proposed rule. The agency typically takes the lead in providing the data, at least initially, with the other parties critiquing and supplementing it. The parties themselves usually have considerable expertise in the subject matter, and hence can work directly with the factual basis of the rule.

During the actual negotiations, the committees have used "workgroups" to address specific issues. These consist of representatives of the parties on the committee, although often they are different individuals than the designated representatives. Frequently they have a particular technical expertise that is the subject of the workgroup. The workgroups may meet the day before the general meeting or between meetings, whatever the group finds convenient. The workgroups are not authorized to make any final decisions, but rather their charter is to report back to the committee as a whole for all substantive decisions.

In some negotiations, the agency has had technical consultants available to address matters that arise during the negotiations. In others, experts have been retained to either help the group as a whole wrestle with a technical issue or to advise some interests that do not have in-house expertise. Both have been significantly helpful in developing the factual predicate of the negotiations.

The negotiations in the committee itself must occur "in the Sunshine" under FACA, and that has caused remarkably little difficulty. The committee members hold frequent private caucuses among allied interest to develop negotiating strategies and reactions to proposals. Again, like the workgroups, nothing that happens in a caucus can have any effect without a group decision made in public by the committee itself. Thus, the public accountability embodied in FACA's requirements is maintained. And, that is particularly important when the substance of a regulation is being deliberated: those who may be affected must have assurance that the decisions are legitimate, and enabling anyone interested to attend the sessions where they are made provides that confidence.

Consensus. The goal of the committee is to reach a consensus on a proposed rule along with a supporting statement of basis and purpose. "Consensus" is an elusive term, and the parties need to understand its implications before agreeing to participate. It ranges in meaning from a simple majority vote, to general agreement (meaning no substantial disagreement), on to unanimity. A workable approach has been for consensus in this context to mean that, unless the parties agree to some other definition at the outset, each interest concurs in the result. This definition does not require each individual to agree, nor does it require that each interest support the outcome affirmatively. It does mean that the participants agree not to challenge the proposed or final rule if consistent with the recommendation.

This definition provides that each interest when viewed as a whole has the power to veto the outcome. That preservation of power is critical in securing the willingness of interests to participate. If an interest felt it could be outvoted in the discussions, it could reasonably believe it would be better off in the more formal, structured process, and it would not want to negotiate directly. This definition meets that concern.

Interestingly, the rigorous definition frequently enhances the ability to reach agreement since it serves to bind the group together as a problem-solving unit and forces each participant to make a decision as to whether on the whole, as opposed to any single provision, that interest is better off.

Agency Agrees to Publish. The agency needs to agree at the outset that it will publish a resulting consensus as a proposed rule unless there is good cause for not doing so. The parties will not incur the time, cost, and agony -- making choices as to internal priorities is always difficult -- that will be involved if the agency whimsically ignores their hard work. The primary incentive for engaging in the discussions is that it is a means for direct participation in the rulemaking process -- it is an adaptation of the legislative process -- and that would be shattered if their work were disregarded. The agency would, of course, need to review the recommendation to ensure that it is consistent with law and the agency's overall policy. But, the consensus would include the assent of the senior agency official and any necessary internal coordinations should have already been done. If, however, the agency head decides the recommendation is inappropriate, he or she would retain the power to refuse to adopt the consensus.

Parties Express Support. The parties to the negotiation need to recognize from the outset that they cannot bind everyone to any agreement they may reach. For example, there may be interests that are not represented on the committee, and even some members of interests that are may not agree with the outcome. Since there is no formal representation, as in labor law where unions bind their members, those interests could still challenge the rule even if the agency adopted the recommendation in toto. One procedural way of dealing with this vexing problem has been to have those organizations and interests that are represented agree to support the consensus in all relevant fora. In that case, a member of the interest who feels aggrieved by the decision may challenge it, but those who participated will file a memorandum saying that they participated in the proceeding and concurred in the recommended proposed rule when considered as a whole. Those charged with making the decision[3] will therefore know it is the individual member of the interest and not the interest as a whole that is disgruntled. That will force the authorities to focus on whether there is a differential effect with respect to that member that was not adequately considered, as opposed to simply a dissenter who seeks more than he was able to achieve at the table; in either event, the decisionmaker will know that that person does not speak for the interest as a whole. The agency will then publish the recommended proposed rule and its supporting preamble as a Notice of Proposed Rule Making. Following publication and whatever other procedures the agency is obligated by law to follow when developing rules, the agency would respond to any significant comments and change the proposed rule accordingly. It would usually be helpful if the agency asked the committee to provide its views on the comments since the group may have considered the matter during its deliberations and developed a position on it. Moreover, the group could furnish important insights into how the comments dovetail with the earlier consensus. The final decision on the rule would naturally belong to the agency.

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[3] The decision maker may be senior agency officials, the Office of Management and Budget, or a reviewing court. For a discussion of the judicial review of negotiated rules, see P. Wald, Negotiation of Environmental Disputes: A New Role for Courts?, 10 Colum. J. Envtl. L. 1 (1985) and P. Harter, The Role of Courts in Regulatory Negotiation -- A Response to Judge Wald, 11 Colum. J. Envtl. L. 51 (1986).

## III
## BENEFITS OF THIS APPROACH

Broader Participation. This procedure enables the parties to participate directly in the development of a regulation of importance to them. Indeed, the process is structured to ensure that more of the interests that would be affected by the regulation participate in its development than would be the case in a traditional rulemaking: the convenor makes an extensive effort to identify those interests and to secure representatives as members of the committee; the Federal Register notice and other publications then enable any other interest that may have been overlooked to state their case as to why they should participate. Any consensus that does emerge is then subjected to the normal rulemaking process, so that anyone else who may be interested can still express their views on the proposal. Thus, the negotiated rulemaking process is designed to ensure broad participation by those with conflicting interests and serves to protect against a limited cabal inflicting its views. Finally, the committee must recognize that its workproduct will be judged against the statute, and hence their recommended rule must meet the precepts established by Congress. That, in turn, serves as a check on making impermissible "side deals" or the consideration of impermissible factors when striking the balance.

Address the Real Issues. Those directly affected are likely to be in a better position than the agency to identify the major issues involved, gauge their importance to the respective parties, determine what information is reasonably necessary for their resolution, develop that information, and reconcile the issues into a rule that meets the needs of the parties as against the requirements imposed by the statute under which they operate. Because of the opportunity for direct participation in making the decisions, the members of the committee can focus directly on the issues involved and have some assurance that they can control the outcome. That in turn reduces much of the distrust and defensive work, and the committee can make a more careful, detailed examination of how the regulation would work in practice. Since the parties will be able to rank the issues in some sort of priority and have an exchange of views on them, they will be able to reach an accommodation that meets their respective needs. The parties can come in from the extremes and control the use and interpretation of data so that it may be more freely provided (although, to be sure, the careful participants would want to do so in a way that protected them if discussions should fall apart).

Moreover, the process can recognize the inherent uncertainty in virtually every scientific question. Instead of trying to prove what the science "is," the parties can focus on what they should do, taking into account the range of uncertainty. The result would be a "better", more practical rule. Many of the negotiations to date, for example, have resulted in fairly stringent rules that take account of the practical difficulties of implementation. Thus, each "side" gained from the process, as compared to what would likely occur if the agency were left to its own devices.

Savings. It is also likely that such a rule can be developed in less time and for fewer resources than under the traditional method. It may look expensive and time-consuming initially, however, since it will require a substantial investment in time and effort for awhile[4] and there will be the extra expense of the convener/

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[4] Because of this up-front investment, it may be difficult for some interests to participate in a negotiated rulemaking because of the drain on limited resources. It may therefore be appropriate to defray the cost of participating in terms of paying for the time of a representative and sometimes for retaining technical experts for interests that are necessary but which could otherwise not afford direct participation. Because these interests work together with the (continued...)

mediator. If the process is successful in reaching a consensus, however, those expenses should be more than offset in the long run savings. The time and cost of hearings and of subsequent judicial review have been substantially reduced since the important issues were raised during the discussions. As a result, the comment period and subsequent proceedings hold few surprises. Moreover, only one rule that resulted even in part from a regulatory negotiation has been subjected to judicial review, in all of the others no one has sued -- a rather remarkable record in its own right. Another important savings is in reducing the cost of uncertainty -- business cannot plan if major issues will be decided in the future.

Success Without Agreement. Even if the group is not able to reach consensus, the effort has proven to be worthwhile. The research conducted will surely be relevant to subsequent proceedings. Participating in the discussions will force the parties to analyze their own needs and decide how to meet them within the confines of the statute and that can prove invaluable in the subsequent rulemaking. Moreover, the committee might still be able to agree on the boundaries of an acceptable regulation, in which case anything within that "region" would be acceptable. In that case, the group would basically turn it over to the agency to "arbitrate" a decision by developing a rule within the confines of the overall understanding of what would be acceptable. The discussions would thus result in a range of acceptability as opposed to the language of a rule itself. Or, even without that, the agency can focus on the issues that genuinely separated the

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4.(...continued)
others in developing a rule for the agency in a way that ultimately will likely save the agency's resources, defraying these expenses is a legitimate cost of developing the rule itself. Providing these resources has been critical to success in the past and will likely be in the future.

I believe Section 11 of S. 1504 strikes an appropriate balance in this regard and applaud its inclusion. It should be made clear, however, that these funds can also be used to retain a technical expert to advise a party; in some proceedings that are extremely technical, the ability to have access to an expert is important.

parties, being relatively comfortable with those on which agreement was reached. Finally, the mere fact of the negotiations will frequently mean that the parties have established a working relationship, at least to some degree, and hence they are less likely to revert back to extremes during the subsequent rulemaking process.

Agency's Role. Negotiating regulations is sometimes opposed on the grounds that only the agency can divine "the public interest" and hence reach the "right" result. Another allegation is sometimes made that the agency is somehow corrupted by the process into accepting anything the participating parties may tender. Neither challenge has merit in either theory or experience.

The agency continues to represent whatever interest it represents in the hybrid process -- be it the public interest distilled from the competing needs of a variety of claimants, advocating the positions of those who are not as well organized as others, pressing for the beneficiaries of a program, or being a shill for the position of others because the agency has been "captured". Unlike the current process, negotiated rulemaking enables the staff to hear directly the concerns, needs, and information of the participants. Moreover, the staff can focus more directly on achieving results instead of building a record for judicial review. Thus, participating in the process actually furthers the ability of the staff to achieve its long range goals. And, importantly, the staff of the agency is required to concur in the rough and tumble of the negotiations and the final agreement. The agency is not a passive player: it continues to represent the "public interest" as it sees it. As Holmes cautioned about the law generally, the public interest is not determined by a brooding omnipresence in the sky. The direct participation of those affected, including the agency, against the criteria established by Congress in the statute, is surely the best way to determine just what the public interest is, as opposed to some self-proclaimed assertion.

As for reaching the "right" result, all we can ever hope for in any proceeding is to achieve a decision within the range of reasonableness as defined by the statute and competing political forces. The legislative process by which the rules would be developed would help ensure that that would in fact happen. The important aspect is that individual components of a negotiated rule should not be compared with those determined by another process -- they may well vary -- but rather to look to the overall, net effect. Will the result be a horse designed by committee? Probably, but so are rules developed by the hybrid process, and anyhow the resulting animal may be better suited to the terrain in which it is to function than would the one under design by the agency itself.

## IV
## SPECIFIC COMMENTS ON S. 1504

As I mentioned at the outset, S. 1504 by and large does a superb job of capturing the spirit of the recommendation of the Administrative Conference and of the best current practice. It should be emphasized again, however, that agencies are fully authorized to use the process under current law, and this bill would codify that practice. Its enactment could facilitate the use of negotiated rulemaking by providing specific Congressional authorization, as opposed to having to reach that conclusion by piecing together several strands of Administrative Law. I therefore support its passage.

By way of specific comments on the bill, I offer the following, which in the aggregate amount to only minor tidbits.

- On page 4, Section 4(6), the convenor assists all the interested parties in determining whether negotiated rulemaking would be the appropriate procedure, not just the agency.
- On page 5, Section 5(a)(7), the provision that "the head of the agency shall consider whether ... the agency to the maximum extent possible, will use the consensus ... as the basis for the rule proposed by the agency for notice and comment" seems anomalous and redundant with the preceding considerations.
- On page 7, Section 6(a)(5), the proposed procedures, or protocols as they have generally been called, are not for the "review and adoption" of the committee, but rather are submitted for the consideration of the committee,

would seem better if the paragraph were changed to read "a proposed set of protocols for the operation of the negotiated rule making committee."

- On page 7, it would also seem helpful if the agency were to publish in the notice who the agency anticipates will represent it in the negotiations. Interested parties may believe that someone else would be more appropriate. It would also make clear that the agency itself will be there.

- On pages 8 and 9, Section 8(b), as I recently testified before this Committee concerning FACA, the agency head should have the direct authority to empanel the negotiating committee under FACA without having to go through the cumbersome bureaucracy of securing an official imprimatur. By having to jump through those hurdles, the official establishment of negotiating committees has been delayed weeks and perhaps months. Surely the agency head can be trusted to make a reasonable decision as to the **process** the agency will use in developing its rule. The provisions of FACA itself ensure that the substantive requirements, such as balance and open meetings, will be met. It is surely inappropriate to force agency heads to have to negotiate with OMB desk officers over whether or not to empanel a committee; I would hope this bill, if not FACA itself, would make that clear.

- On page 10, Section 8(c), the first two sentences are in conflict with one another, and the first is right. The mediator serves at the will of the committee, as captured in the first sentence. The second sentence would limit that, however, to saying the committee must have "good reason" before deciding it wishes someone else to fill the role. That requirement should be deleted.

- On page 11, Section 8(e) should be changed to provide that the mediator shall not "participate in" any agreement; voting is only one way of reaching agreement, and the provision should emphasize that the agreement is for the parties, not the mediator.

- On page 11, Section 8(f), in keeping with my earlier comment, I would suggest the term "procedures" here be changed to protocols. Also, the last sentence probably should be qualified to make clear that the exception applies only to "procedures" or "protocols" as described in "this paragraph" and nothing more general than that.

- On page 12, Section 8(g), although the language itself is likely to be satisfactory, two things need to be recognized with respect to this section. First, the committee may well not reach final agreement, at least initially, on a full preamble to the rule; once the committee reaches agreement and expresses the general basis for it, the agency itself typically prepares the preamble consistent with the rule and deliberations of the committee. It would, of course, be helpful if the committee itself were able to review the draft to ensure that those two requirements are met.

  Secondly, if the committee is not able to reach an agreement it may be highly inappropriate to describe just why. The parties should be assured that they will not be hurt by agreeing to participate in the negotiations, and a report stigmatizing one of them -- or even the potential of that happening -- could do just that. Thus, in some instances, it may be that the committee would want to describe the range of disagreement and tender the matter to the agency to decide within the range defined by the proposals. In other instances, the committee might believe that all the provisions of the rule are so intertwined that a disagreement as to any major portion means there is no agreement as to anything; in this case, the only report should be, "The committee was unable to reach agreement." By describing the various items and where people were on them would at best be misleading and at worst quite damaging.

- On page 14, Section 11(b), the major point to be made with respect to caucuses and workgroup meetings is that decisions as to all recommendations that are to be made to the agency must be made by the committee as a whole and in a public meeting, unless one of the exceptions contained in the Sunshine Act applies. Thus, it is appropriate to hold private caucuses because they do not make recommendations to the agency, but only help define what will be presented in the plenary session of the committee.

- On pages 15 and 16, Sections 12(a) and (d), these provisions should be made entirely voluntary on the part of the agency. While I certainly support the role of the Administrative Conference generally and with respect to fostering reg neg in particular, I think it is inappropriate to **require** agencies to report to it and provide that they "should" consult with ACUS. Hell hath no fury like a regulated regulator, and imposing requirements -- even precatory "shoulds" -- on agencies will only inhibit the use of the process. To the extent the bill wishes to point out to agencies that they would likely find it helpful to draw on ACUS's experience, the bill should be amended to provide that the agency "may" consult with ACUS.

- On pages 13 and 15, Sections 10(a), 12(b) and 12(c), while these sections probably contemplate it, the bill or its legislative history should make clear that someone whose name appears on the roster, and hence has met some criteria and who is acceptable to the broad range of interests on the committee, should be able to be hired directly, without having to go through an enormously expensive and time consuming selection process. Securing the services of a neutral -- the mediator -- currently is a cumbersome process that can add extensive delay to getting a negotiated rulemaking up and running. The typical way of securing their services in the private sector is for the parties to select from a roster. In this case, the agency itself would make the initial selection, but subject to the approval of the parties. The public nature of the process would appear to afford the normal protections of competitive bidding. Thus, the statute should authorize some agency -- be it any agency wishing to use this process or ACUS itself -- to negotiate with the neutrals on the roster to secure the appropriate rate and overhead figures, so that an agency can procure their services expeditiously.

I am delighted to support S. 1504 and would hope that it receives serious consideration. Thank you.

May 13, 1988

# SUPPLEMENTAL STATEMENT OF PHILIP J. HARTER
# BEFORE THE
# SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
# CONCERNING
# S. 1504, THE "NEGOTIATED RULE MAKING ACT"

I would like to address one additional point that I believe is important for current regulatory negotiations and is critical to effectuate provisions of S. 1504. As I mention in my testimony and as others today will surely emphasize, the cost of participating in a regulatory negotiation can sometimes be fairly substantial compared to the budgets of some of the organizations that need to be represented. Since the members of the committee are working closely with the agency in developing a mutually satisfactory rule, those people are in fact supplying services to the agency for the responsible discharge of its duties. It is, therefore, appropriate -- as S. 1504 recognizes -- to defray the costs of participation in some instances. I applaud that provision.

The difficulty arises from the interplay of various obscure requirements embodied in the conflict of interest statues. Section 207 of the Criminal Code prohibits any special government employee from representing any other party in any "particular matter involving a specific party ... in which he participated personally and substantially as ...an employee through ...the rendering of advice...." 18 U.S.C. § 207(a). Although inconsistent with traditional concepts of administrative law, the Department of Justice and the Office of Government Ethics have taken the position that the term "particular matter involving a specific party includes "rulemaking and general policy matters, and extends to all discrete matters that are the subject of agency action, no matter how general the effect."[1]

Thus, if a member of a negotiated rule making committee were to be regarded as a special government employee, it would be a crime for them to represent any other party in the resulting rule making proceeding. That would certainly seem to say that it would be illegal to file comments in response to a Notice of Proposed Rulemaking on behalf of their employing organization.

The authoritative guidelines on the application of the conflict of interest statutes to advisory committees say categorically:

> A person who receives compensation from the Government for his services as an adviser or consultant is its employee and not a representative of an outside group. However, the Government's payment of travel expenses and a per diem allowance does not by itself make the recipient an employee.[2]

Therefore any member of a negotiated rule making committee that is compensated for their participation -- as is contemplated by the Federal Advisory Committee Act itself[3] -- would be regarded as a special government employee and would per force be prohibited from any subsequent role in the rule making. This anomaly should be corrected for reg negs in general, but it is especially imperative for the effectiveness of this bill.

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[1] Testimony of Frank Q. Nebeker, Director, Office of Government Ethics, before the Senate Committee on Governmental Affairs on The Federal Advisory Committee Act, April 19, 1988 at 9.

[2] Memorandum of July 9, 1982, from J. Jackson Walter, Director, Office of Government Ethics, to Heads of Department and Agencies of the Executive Branch, at 4; emphasis in original.

[3] See § 7(d), 5 U.S.C. App I.

To remedy this serious shortcoming, I suggest that Section 11(c) be amended by adding the following sentence:

> The payment of compensation pursuant to this Section or Section 12 shall not be considered with respect to the determination as to whether any member of a negotiated rule making committee is a Special Government Employee.

If this sentence were added, the question as to whether or not a participant is a special government employee would turn solely on the substantive factors that are customarily used to determine that status, and whether or not that person is compensated for the service would be irrelevant, as it should be.[4]

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[4] As I have developed in detail in prior testimony before this Committee, the standards used to determine that status are inconsistent both with themselves and with other, broader bodies of law. Testimony of Philip J. Harter before the Senate Committee on Governmental Affairs concerning the Federal Advisory Committee Act (December 3, 1987) and accompanying memorandum.

# Testimony of Kelly M. Brown
Executive Engineer, Automotive Emissions and Fuel Economy Office
Ford Motor Company
Before the Senate Committee on Governmental Affairs
May 13, 1988

Ford Motor Company appreciates the opportunity to present its views on negotiated rule making and offer comments on S.1504, "The Negotiated Rule Making Act".

Ford believes that, in certain situations, the negotiated rule making procedures outlined in this bill can be a beneficial supplement to the conventional rule making process.

Ford has a direct interest in assuring a fair and efficient regulatory process. We are the second largest manufacturer of cars and trucks in North America. We also have interests in financial services and diversified non-automotive technology, such as electronics and aerospace communications. Our businesses are controlled by a multitude of regulations administered by numerous Federal regulatory agencies. These regulations include requirements for emissions, safety, fuel economy, commerce, employment, taxes, securities, finance, communications and other aspects of our business.

The conventional rule making process is complicated and can sometimes be adversarial in nature. In certain situations, the conventional process could be improved by promoting an exchange of views among affected parties. Negotiated rule making is one way to allow all affected parties to participate in a shared commitment toward achieving consensus on a workable proposed rule.

Ford twice has participated in negotiated rule making. The first involved Environmental Protection Agency (EPA) rule making for heavy-duty truck emissions. The other involved Federal Trade Commission (FTC) rules for the regulation of informal dispute settlement mechanisms.

There were different reasons why the agencies involved in each of these cases chose to use negotiated rule making. I participated in the EPA rule making and will describe those negotiations first.

EPA was directed by Congress under the Clean Air Act to establish rules for levying nonconformance penalties (NCP) in instances when a manufacturer of heavy-duty trucks cannot achieve certain federal emission standards. Without NCPs, a manufacturer would be prohibited from producing those products that are not able to meet emission standards.

EPA first issued an advanced notice of proposed rule making for NCPs in accordance with their statutory obligations. The comments received in response to the proposal were not favorable.

It was clear to EPA that it would be difficult to issue a rule by way of the conventional rule making process. Therefore, EPA decided to pursue negotiated rule making in an effort to resolve some of the differences among the affected parties.

Initial meetings were convened in April, 1984. Participants included Ford and other heavy-duty truck manufacturers, the Motor Vehicle Manufacturers Association, the Automobile Importers of America, the Natural Resources Defense Counsel, the California Air Resources Board, the Engine Manufacturers Association and the Environmental Protection Agency.

At the outset, exchanges among participants were somewhat tenuous and guarded; but, as the interactive process evolved, there was a more open sharing of ideas and a sense of commitment. After numerous meetings, a consensus position was achieved in November of the same year.

Two points are worthy of mention. First, there was considerable discussion on the need for compensation allowances and associated eligibility requirements. This was resolved by agreeing to provide limited travel funds only to parties with legitimate interests that otherwise would not have been able to participate because of financial hardship.

Second, the participants were able to reach consensus on all key aspects of the rule making. However, on one issue we agreed to disagree. This involved the question of whether future heavy-duty truck emission standards should be based on the capabilities of the technological leader and require all others to pay non-conformance penalties. The matter was resolved subsequently in the courts during proceedings involving another rule making.

The important consideration is that the participants ultimately achieved consensus on the key issues of the rule. This led to EPA issuing a final rule in August, 1985, based largely on the negotiated recommendations.

The reasons for using negotiated rule making in the FTC situation were quite different. In this instance, there was general dissatisfaction with an existing rule, FTC Rule 703, that implements portions of the Magnuson-Moss Warranty Act. Briefly, this rule permitted warrantors to incorporate informal dispute settlement procedures into their written warranties for resolution of consumer complaints and required consumers to use these procedures before bringing suit under Magnuson-Moss.

The general dissatisfaction with the rule resulted from the fact that the FTC had not established requirements for certification of manufacturers' dispute settlement procedures. Therefore, manufacturers had no means of determining whether their procedures complied with the rule. In addition, many warrantors were not utilizing these procedures to address consumer complaints.

The FTC, recognizing these and other problems with the rule, decided in 1986 to assemble an Advisory Committee comprised of state, consumer, industry and FTC participants to engage in negotiated rule making. Ford elected to participate in the negotiations to help resolve the misunderstandings that existed between product manufacturers and consumer protection groups.

The negotiations took place over the course of ten months, concluding in June, 1987. Unfortunately, the negotiators failed to achieve a consensus. Nonetheless, Ford believes participation in the process was productive and beneficial in promoting greater understanding among the diverse interests involved.

Ford believes that negotiated rule making can be a beneficial supplement to the conventional process in some situations. When properly used, it can facilitate discussions between affected parties and lead to a better rule.

By bringing together all the parties that are genuinely affected by a rule in its early formulation stages, all concerns can derive significant benefits from the negotiation process. In a face-to-face, open forum where ideas can be exchanged freely, there is greater chance of finding common ground for an acceptable rule. In addition, there also is a greater likelihood that the participants will support the final rule and be more committed to making it work.

This does not mean that the negotiated rule making process will always result in a consensus. Even when a consensus is not reached, the process still can be beneficial in helping to structure a proposed rule.

The negotiated rule making process may require a greater commitment of time and effort as compared with the conventional rule making process. In those instances where negotiated rule making is appropriate, however, the final outcome may be worth the extra effort.

Based on our experiences, Ford believes the negotiated rule making process can be most beneficial in circumstances where: 1) the parties are involved prior to issuance of a proposed rule, 2) participation is confined to a relatively small number of legitimate parties, 3) all participants are committed to working toward an equitable rule and 4) the process has a specified end date.

S.1504, "The Negotiated Rule Making Act", would encourage greater utilization of the negotiated rule making process. The bill would facilitate use of this process by authorizing agencies to conduct negotiated rule making in accordance with procedures recommended by the Administrative Conference of the United States.

In addition, the bill properly delegates authority for use of the negotiated rule making process to the administrative agencies. This will assure that each agency has the latitude to decide when the process can best be used as a supplement to the conventional NPRM process.

More specifically, we would like to offer comments on two areas of the bill. The first concerns references as to who should participate in the negotiations. In some sections, the bill refers to "affected" parties; in other sections, it refers to "significantly affected" parties. Ford believes the bill consistently should limit participation in each reference to only those parties that would be significantly affected by a proposed rule.

The second concerns the judicial review provisions of the bill (Section 13). While we believe there should be commitment on behalf of the participants to the agreements made in the consensus process, the bill would restrict judicial challenges regarding agency decisions made subsequent to the negotiations. We believe the language should be revised to preserve legitimate judicial rights for all parties.

In summary, Ford supports the concept of negotiated rule making as a supplement to the conventional rule making process. S.1504 would provide guidance and facilitate use of the process in situations where negotiations could help in developing a final rule.

# Testimony of

## David D. Doniger

Good morning, Mr. Chairman. My name is David Doniger, and I am a senior attorney for the Natural Resources Defense Council. I am pleased to testify today on regulatory negotiation and S.1504.

Let me begin with a short description of the Natural Resources Defense Council. NRDC is a non-profit citizen organization founded in 1970 to work for protection of public health and the natural environment. We have 83,000 members nationwide and a professional staff of approximately 80 located in offices in Washington, New York, and San Francisco. About half of our staff are attorneys and half scientists and other resource specialists. We work on a wide range of issues, including control of air and water pollution and hazardous wastes; promotion of energy efficiency; coastal resource protection; agricultural and forestry policy; public lands management; verification of nuclear weapons testing; and prevention of stratospheric ozone depletion and global climatic change.

NRDC is strongly supportive of negotiation as one important tool for resolving disputes over public health and environmental policy. As everyone on the Hill knows, negotiation and compromise are an inevitable ingredient of government. In NRDC's work, negotiation takes many forms ranging from settlements of lawsuits to development of consensus legislation. We have been involved over the years, quietly and behind the scenes, in innumerable informal negotiations that occur between the parties during agency rulemakings. In addition, we have participated in several of the experiments in negotiated rulemaking undertaken by the Environmental Protection Agency and, in one case, the Department of the Interior. (I have compiled an illustrative history of NRDC's use of negotiation in the attachment to this testimony.)

As our own activities indicate, a lot more negotiation goes on than some people assume. Environmental disputes -- at least those waged at the national level before agencies such EPA, DOI, OSHA, or other agencies -- involve sophisticated, experienced parties and representatives. Both industry and the environmental community have been around long enough to have developed a sense for when to fight and when to negotiate. They have also developed considerable skills in negotiation. As a result, many disputes are resolved, or at least defined and narrowed, by forms of negotiation.

We believe the experience to date with negotiated rulemaking is showing that it can be useful for resolving some kinds of environmental policy disputes. It is developing into a kind of "niche" tool appropriate for a small but potentially significant subset of environmental issues. We will continue to look for opportunities to make health and environmental gains through "reg negs." We share the desire of the sponsors of S. 1504 to encourage use of negotiated rulemaking in appropriate cases.

In our view, however, negotiated rulemaking is still in a fragile, experimental stage. The process of calling and conducting a negotiated rulemaking is still largely ad hoc, because each situation so far has been essentially unique. Widely varying reasons have brought parties to the table in the various cases. Some "reg negs" have resulted in broadly shared consensus; others have broken down, sometimes bitterly. It is still difficult to predict when a "reg neg" will work and when it will not, how it should be structured, and who should have what role.

It must also be recognized that while there are tangible advantages to "reg negs" when they succeed, there are also significant costs. First, there is a danger that the "reg neg" process will tend to convert agencies with congressionally-assigned missions into mere brokers between interest groups. This has happened in some cases, and not in others. Second, "reg negs" are extremely expensive for the public interest sector. They take far more staff time than conventional rulemaking -- and even more time than typical post-rulemaking litigation where that is necessary. Third, there is a potential to set back relations between parties by forcing attempts to negotiate inappropriate issues. NRDC is still feeling its way case-by-case in determining what issues are suitable for this process, how to fund it, and how to get the best results from it.

For these reasons, we think it would be best not to legislate a specific set of procedures for negotiated rulemaking at this time. It would be better to let the experimentation and learning continue for a while longer. We think this is especially so since there are no obstacles to conducting "reg negs" under present law. Greater use of "reg neg" will be better fostered by a proliferation of successful examples and "satisfied customers" than by the passage of a law establishing a set of procedures.

Let me address these points in turn.

## 1. "Reg Neg" Can Be Appropriate for Resolving A Significant But Relatively Small Subset of Environmental Disputes

Several successful examples of "reg neg" show that it can be a useful technique for resolving a number of environmental disputes. But there have also been significant mistakes where attempts were made to negotiate issues that involve non-negotiable principles, were too complex, or were otherwise unsuitable.

One conclusion we have drawn is that while peripheral or second-level issues are sometimes negotiable, central issues rarely are. The successful negotiation of EPA regulations for determining truck engine nonconformance penalties illustrates the former proposition. There were many potential ways to structure that formula, and none went to anyone's core principles. Likewise, many aspects of the EPA woodstove emission rules (e.g., testing and audit procedures, hearing procedures) were implementation details relatively amenable to negotiation. These are examples where the final rule reflects ideas developed in the negotiation process that might never have been generated at all in the normal process.

Issues of fundamental principle, however, are virtually impossible to negotiate. EPA once toyed with the idea of negotiating siting criteria for low-level radioactive waste disposal sites; that idea foundered on the non-negotiability of the fundamental question how much cancer risk is safe.

Likewise, straight-up questions of statutory construction are also very unlikely candidates if the answer is important to affected parties. In EPA's underground injection negotiations, the central issue was the statutory requirement of "no migration" of hazardous wastes from the injection zone. This negotiation broke down, despite long and hard efforts by NRDC staff, because other parties insisted on approaches that we believed would effectively repeal the statutory "no migration" requirement.

From the environmental community's point of view, the key issue in resolving many disputes is how to give industry a reason to prefer action to delay. "Reg negs" are often impossible for the same reason that legislation is difficult: Industry often does not want anything done. In our experience, industry has come to the table for a negotiated rulemaking only when the alternative looks worse -- when EPA, Congress or the states are moving forward. With woodstoves, for example, the industry was brought to the table by the fact that an increasing number of states were setting up their own regulatory programs for woodstoves. As manufacturers of a product sold in many states, the woodstove makers found a single federal program much preferable to multiple state programs. That gave environmentalists, states, and the EPA some leverage. In short, the industry wanted a federal standard so badly they were even willing to accept a good one. Similar motivations on the part of other industries are relatively rare.

## 2. "Reg Neg" Must Not Turn Agencies With Statutory Missions Into Merely Passive Brokers

One of the most serious concerns for the environmental community is that "reg neg" must not convert agencies with missions into passive brokers between outside interest groups. Congress intended the EPA, for example, to be an activist advocate for protection of health and the environment. Yet, especially in this Administration, EPA has taken a very passive role. We are concerned that regulatory negotiation may accentuate this trend to passivity -- that it may further encourage agencies to withdraw from the fray and leave environmental groups and industry to fight things out and "let us know who wins." In this situation, environmentalists have the most to lose. We lose the agency as a source of data and analysis, and as an advocate for environmental improvement.

This has happened in some "reg negs" and not in others. In the heavy-duty engine penalty negotiations, EPA staff were almost invisible much of the time. One of the first points of agreement between the industry caucus and the environmental and state caucus was that EPA had to come out of its shell and be a full partner in the discussions. On the other hand, the EPA team in the woodstove negotiations deserves much credit for its active and hard-headed role.

Why this agency passivity happens sometimes and not others is something that needs to be better understood before a greater commitment to "reg neg" is made. If this situation turns out to be common, the environmental will have great difficulty supporting broader use of "reg neg." This is an issue we should learn more about as the experimentation proceeds, and it is strong reason for not over-promoting "reg neg" at this time.

### 3. "Reg Neg" Is Extremely Expensive, Especially For The Non-Profit Public Interest Sector

In our experience, the "reg neg" process has proved extremely expensive. For example, in the woodstove negotiations, I personally devoted nearly 30 full days to the process -- easily three to six times more time than it would have taken to write conventional comments. While we achieved a good outcome in that case, in other cases an equally intense effort has come to nothing. This was the case in the EPA underground injection negotiations, which broke down, and may be true again in the Department of the Interior (DOI) negotiations over the air pollution from offshore oil development, which as of now are stalled.

Non-profit environmental organizations simply cannot afford this effort on a regular basis. There has been some effort in several negotiations to raise funds from foundation sources to form a "resource pool" to defray these costs. In the EPA negotiations, however, NRDC has never received more than travel expenses. In the DOI negotiations some money was raised from California state and local governments to help pay for the expenses of the outside attorneys and technical consultants and the in-house staff working on the issue, but expenses were not covered.

One argument for "reg neg" is that it may save agencies money by reducing the controversiality of issues and thereby allowing the agency to forego the some of the redundant technical studies and economize on other expenses usually incurred to support a rule. While this may be true, the effect of "reg negs" is to transfer large costs to the non-governmental participants. It seems only fair then that the sponsoring agency defray some of those expenses for the non-profit sector least able to afford them.

Under the present Federal Advisory Committee Act, agencies can reimburse members of advisory committees for their participation. In the "reg negs" we are familiar with, however, the agencies have declined to do so. I am not sure whether the objection to such compensation is coming from the EPA itself or from the Office of Management and Budget, which in the past has attempted to cut off advisory committee compensation. S. 1504 would not fix this problem in its present form, for it merely reiterates the authorization for compensation. I note the useful suggestions of the Conservation Foundation in this regard. Without more, agencies are still likely to decline to reimburse non-profit "reg neg" participants for the enormous expenses involved.

## 4. Deadlines Are Essential To Successful Negotiations

Anyone involved in negotiations knows that deadlines are an essential requirement for success in tough disputes. Both of the successful "reg negs" in which NRDC has been involved were conducted under court-ordered deadlines (arising from prior agency failures to meet statutory deadlines). Several of the failures are attributable, at least in part, to the absence of any deadline for action by the agency, the courts, or the Congress. Without deadlines, "reg neg" can be used by an agency or by some participants as part of a strategy of delay.

S. 1504 does not address this problem accept to cite the existence of deadlines as a factor to be considered in assessing the prospects for successful negotiations. What is needed is a provision requiring that, where there is no statutory or court-ordered deadline, an agency considering a negotiated rulemaking must specify a date on which it will act, either on the basis of the consensus of negotiations, or on its own if no such consensus has emerged. The provision should make this deadline binding on the agency and enforceable in the courts in the same manner as a statutory deadline is enforceable under the citizen suit provisions of most environmental laws. The deadline should be subject to change only with the agreement of the parties to the negotiation.

## 5. Procedures Placing Decisions Solely In The Hands Of Agency Officials May Harm Prospects for "Reg Neg"

I believe one reason parties have been willing in some cases to take some risks and "give it a go" in negotiated rulemakings held to date is the knowledge that the process is extremely fragile. It requires a continuous consent of the parties, and cannot survive significant dissension. This means that the parties have a safety valve if things start to go badly in the "reg neg" process: the important parties probably can stop the process unilaterally if they want to.

The bill, however, gives agency officials the sole authority to make major process decisions (whether to hold a negotiation, who to invite, when to continue or call off negotiations, etc.). To be sure, consultation with conveners, facilitators, and the parties is required. But in the end the agency head makes these decisions. What is more, his decisions are totally insulated from judicial review. We are concerned that by placing the responsibility for decisionmaking throughout the process in the sole discretion of agency officials, the bill may unintentionally upset the fragile, consensual atmosphere that is necessary to make "reg neg" work. As a result, parties may be less willing to take the kind of risks involved in the process. If that happens, then the bill may result in less negotiated rulemaking, not more.

We have not come up with specific language changes to fix this problem, for it is difficult to see where to assign the process powers if not to the agency, and it does not appear that adding a layer of judicial review is the answer either. This is one of the main reasons why NRDC believes it is better to hold off on "reg neg" legislation at this time and allow experience to continue developing.

### 6. Experimentation With "Reg Neg" Should Proceed, But Legislation To Codify Procedures Is Premature

To conclude, in NRDC's view, we are all still experimenting with a new tool. Negotiated rulemaking is showing itself to be a valuable tool in the right circumstances, but it has also exhibited some serious problems. While some insights are emerging about when to use this tool and when not to, the experiments thus far have also shown that results are unpredictable. To use an industrial analogy, we are still at the pre-market testing stage of making hand-crafted prototypes and trying them out in laboratory conditions. It is still premature to release this product to the market.

For these reasons, NRDC believes it would be best at this point to allow the experimentation with negotiated rulemaking to continue without codification in legislation. The better way to encourage the positive development of this tool is for its advocates -- members of this Committee, the dispute-resolution community, agencies which have had positive experiences, and past and potential negotiating parties -- to continue informally urging others to explore the potential for "reg neg" in appropriate circumstances. The best encouragement for this process will be the proliferation of successful examples and "satisfied customers."

Thank you for the opportunity to testify, and I am happy to answer any questions you may have.

## Appendix: Illustrative Description of Natural Resources Defense Council's Use of Negotiation

Negotiation takes many forms in the work of the Natural Resources Defense Council, ranging from settlements of lawsuits, to formal and informal negotiation in the context of agency rulemaking, to development of consensus legislation.

Since it inception, NRDC has been able to resolve many lawsuits through settlement agreements. Two of the most important litigation settlements we have accomplished were:

- The toxic water pollutant consent agreement, reached with EPA in 1976. The agreement providing for regulation of some 65 hazardous chemicals discharged into the nation's waters from 21 different types of industries. Congress subsequently adopted this agreement into law in the 1977 Clean Water Act amendments.
- The stratospheric protection plan, reached with EPA in 1986. The plan included a schedule for rulemaking on emissions of chlorofluorocarbons (CFCs) that will culminate on August 1 of this year. It also provided for development of a comprehensive risk assessment and the holding of domestic and international workshops that proved crucial to the negotiation of the Montreal protocol on protection of the ozone layer.

NRDC has also been centrally involved in numerous direct negotiations with industries. These have involved both legislative and regulatory matters. Two of the most important legislative examples are:

- The National Appliance Energy Efficiency Act of 1987. NRDC took the lead in negotiating with the makers of major appliances (refrigerators, air conditioners, etc.) consensus legislation establishing progressively higher energy efficiency standards from now through the mid-1990s. The legislation passed almost by acclamation.
- Pesticide reform legislation. NRDC had a key role in negotiations in 1986 with the National Agricultural Chemicals Association on a comprehensive rewrite of the Federal Insecticide, Fungicide, and Rodenticide Act.

> This agreement serves as the basis for pesticide legislation currently under consideration, and although the consensus has not proved as durable in this area, the cause of pesticide regulatory reform was undoubtedly advanced by the negotiation process.

NRDC also negotiated directly with the oil industry an agreement over oil leasing in the ecologically sensitive Bering Sea off Alaska. This agreement settled a dispute over the Department of the Interior's leasing plans which otherwise clearly would have carried through to the courts and Congress.

NRDC has also had extensive experience, both successful and unsuccessful, with the subject of this hearing: regulatory negotiation. NRDC participated in two "reg negs" that reached satisfactory agreements:

- Nonconformance penalties for truck engines. In 1984 NRDC, the nation's heavy-duty engine manufacturers, state representatives and EPA negotiated a formula for calculating penalties due under the Clean Air Act for the sale of engines that do not meet emission standards.
- Woodstove emissions. By their sheer numbers, woodstoves represent a large and growing source of toxic air pollution. In 1986 NRDC took the lead for environmentalists in successful negotiations with manufacturers, EPA, and states over an emission standard for new woodstoves. By making stoves cleaner and more efficient, the agreement will save lives and at the same time reduce wood costs by millions of dollars.

NRDC has also participated in or observed several other regulatory negotiations, however, which have not come to consensus. These include EPA regulations for controlling underground injection of hazardous wastes and the escape of toxic wastes from deep wells into groundwater. Underground injection is an example of an issue that should not have been put to regulatory negotiation. This is not only our conclusion after the fact, but was also the recommendation of a number of specialists in facilitation and mediation beforehand. In their view, the key issue in this negotiation was a straight-up question of statutory interpretation on which compromise was unlikely. Also the technical issues were too complex to be resolved in this setting and under the operative time constraints. Despite a long and determined effort by NRDC and other environmental participants, the negotiations reached an impasse and were disbanded.

NRDC is also a party in negotiations over Department of the Interior (DOI) regulations for limiting the air pollution emissions of oil drilling off the California coast. The offshore oil negotiations are still formally underway but appear stalled at this time.

We have also observed a number of other negotiations in which we did not have a role: the pesticide emergency exemption regulations, where consensus was achieved; the farmworker protection negotiations, which broke down; and the asbestos in schools project, which although a consensus was declared left important parties dissatisfied and has not avoided litigation.

## WRITTEN STATEMENT OF THE

## CHEMICAL MANUFACTURERS ASSOCIATION

Mr. Chairman and members of the Committee, I am David F. Zoll, Vice President and General Counsel of the Chemical Manufacturers Association ("CMA"). [*] CMA welcomes this opportunity to express its support for regulatory negotiation and for S. 1504, the Negotiated Rule Making Act of 1987. CMA has consistently supported regulatory negotiation and other procedures to enhance the quality of regulations and foster communication between agencies and those potentially affected by regulations. If properly implemented, S. 1504 should help meet those goals.

CMA participates in scores of federal rulemaking proceedings each year. Most of these relate to environmental, safety and health issues. But CMA also takes part in agency activities relating to international trade, tax, energy, transportation, and other business matters. Consequently, CMA has a strong interest in procedures that improve the quality of regulations.

We congratulate this Committee for taking the time, in the face of a Senate agenda crowded with other important issues, to focus on procedural recommendations for our administrative law system. Organizations which participate in the trenches of the regulatory arena appreciate the enormous importance of procedures. But procedures do not provide an attractive topic for Congressional hearings. You are to be commended for devoting a portion of this committee's time to considering ways to enhance agency procedures.

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[*] CMA is a nonprofit trade association whose membership represents more than ninety percent of American productive capacity for basic industrial chemicals.

A word of caution is in order about the subject of these hearings. Regulatory negotiation is not a panacea. It will not be suitable for all regulatory proposals. In fact, it will be suitable for perhaps only a comparatively small subset of the regulatory agendas of our agencies. And even as we join in encouraging regulatory negotiations as an additional regulatory tool, we recognize that we are encouraging a new cultural attitude as well as a fragile set of procedures. We should encourage it persistently, but gently. We should define success as steady, incremental progress. We should not measure it only in terms of great leaps forward in the adoption of regulatory negotiation procedures.

Having offered these words of caution, however, I want to emphasize that regulatory negotiation can offer dramatic results in both the efficiency of our administrative process and, most importantly, in the substance of regulations themselves.

We are sometimes too quick to criticize the legal system of our country because of its formality and because of the resources it consumes. We fail to pay it enough respect as a remarkable institution of our democracy. But the unfortunate fact of the matter is that our formal administrative and litigation procedures have too often become "standard operating procedure" even though they do not always serve us well in the increasingly complex regulatory arena. Regulatory negotiation can be a useful new option for our federal agencies.

As you requested in your invitation, I will:

1. Outline CMA's experience with regulatory negotiation and describe the factors we consider in evaluating regulations as candidates for negotiation.
2. Describe our view of some of the benefits of negotiated rulemaking.
3. Identify some disadvantages of negotiated rulemaking.
4. Suggest an answer to the question of whether negotiated rulemaking is cost-effective.
5. Offer suggestions for possible improvement in S. 1504.

## CMA's EXPERIENCE AND ITS CRITERIA FOR PARTICIPATION

CMA is interested in preventing the development of unsound regulations -- regulatory requirements that are either inefficient, unnecessary, or ineffective. Although regulatory negotiation is essentially a procedural innovation, it can have a positive impact on the substance of regulations. Generally, the extra resources needed to comply with inefficient regulations are greater than the resources devoted to develop them. Substantive improvements of only one major regulation would repay many times the amounts that S. 1504 authorizes to support regulatory negotiation activities.

CMA has participated in several regulatory negotiations:

a. OSHA- methylenedianiline (MDA)

The Occupational Safety and Health Administration (OSHA) initiated a negotiated rulemaking proceeding in June 1986, to develop rules for a full scale workplace standard for MDA. Negotiations proceeded from August 1986 through May 1987. The result was a final consensus recommendation for the adoption of specific regulations.

b. EPA- underground injection

The Environmental Protection Agency (EPA) initiated a negotiated rulemaking proceeding to develop regulations under the 1984 Resource Conservation and Recovery Act Amendments for the underground injection of hazardous wastes. Negotiations began in September 1986 and continued into April 1987. Although a consensus rule did not result, the participants did achieve tentative agreement on a broad range of important issues that formed a substantial basis for EPA's proposed rule.

c. OSHA- benzene

In late 1983 and 1984, CMA met with a number of industry and labor representatives at the invitation of OSHA in an effort to reach a consensus on OSHA benzene regulations. This effort failed to achieve a consensus rule, but contributed significantly to the final benzene rule adopted by OSHA in September of 1987.

d. EPA- PCBs.

In the early 1980s CMA participated in a pioneering negotiation effort with the Environmental Defense Fund and the Natural Resources Defense Council, but without agency participation, to develop regulations governing the inadvertent generation of PCBs in some chemical manufacturing operations. Those negotiations yielded a recommendation that was proposed by EPA and ultimately adopted in July 1984 in essentially the same form. CMA continues to work with other industry and environmental groups to propose recommendations to EPA on a variety of PCB issues.

e. EPA - RCRA

Between September 1986 and February 1987, CMA, 19 other representatives from environmental, citizen, state, and waste management groups, and EPA, negotiated what became an EPA proposed rule to improve the procedures for modifying RCRA treatment, storage, and disposal facilities permits. The group addressed more than 100 different types of permit modifications and agreed on one of three procedural approaches for each modification. EPA should issue a final rule soon. [*/].

Your invitation asked how CMA decides whether to participate in regulatory negotiations. We do not have formal criteria to evaluate candidate issues. In general, we would consider participation in the negotiation of any regulation of significance to our industry. Looking at our prior experiences, however, it is possible to identify the factors which have been important to our decisions to participate, such as:

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[*/] In addition to having participated in these activities, CMA commented favorably on EPA's 1983 Regulatory Negotiation Project (48 Fed. Reg. 7494, Feb. 22, 1983). It identified new source performance standards under the Clean Air Act, toxic pollutant delisting procedures, and financial responsibility rules under the Resource Conservation and Recovery Act (RCRA) as candidates at that point in time for regulatory negotiation.

a. Whether the subject of the rulemaking was significant to the chemical industry;

b. Whether a constituency group existed within CMA that was prepared to sustain CMA's participation;

c. Whether CMA's interests would be adequately protected by some other group's participation;

d. Whether the necessary staff and financial resources were available to support CMA participation;

e. Whether all groups likely to challenge a final rule had been invited to participate;

f. Whether negotiations would likely be undertaken in good faith by each of the participants;

g. Whether the agency was prepared to devote adequate staff resources to ensure an opportunity for success;

h. Whether the agency was committed to using any resulting consensus as the basis for its proposed rule;

i. Whether any participant had more to gain from scuttling the process than having it succeed; and

j. What the rulemaking proposal was likely to look like in the absence of negotiations.

## THE BENEFITS OF NEGOTIATED RULEMAKING

### 1. Negotiations Can Improve the Technical and Scientific Foundation for Regulations

Far too often agencies propose a rule without having an adequate technical or scientific understanding of what it is they are regulating. The result: regulations don't fit the problems they are attempting to solve. The agency proposes requirements that are unnecessary or poorly suited to the agency's objectives, or else an agency may overlook an opportunity to economize. The dialogue afforded by face-to-face negotiations permits the identification of targeted solutions to regulatory objectives.

Now, this "educational" function can be a two-edged sword. Some people may believe they run the risk of creating more knowledgeable opponents. Any such "disadvantage", however, is more than offset by the enhanced ability of all participants to understand the pros and cons of alternative regulatory requirements. In fact, we have found the "education" process sometimes lessens our adversaries' instincts to *automatically* oppose any industry proposals.

### 2. Negotiations Facilitate Basic Conceptual Changes

Once a flawed regulation is proposed, it is often difficult to change. As a proposal moves through an agency, it becomes increasingly difficult for the agency to consider that its basic concepts may be flawed. The agency responds to public comments by merely tinkering with its proposal in order to produce a final rule.

Negotiation, in which all significant interests are well represented, affords greater freedom and flexibility for the agency to adopt major departures from its original, flawed concept of a rule.

### 3. Negotiations Identify A Middle Ground Where Interests Can Be Balanced

Parties to a rulemaking, in anticipation of judicial review, normally draft comments as though they were already litigation adversaries. Industry and environmental groups may avoid unilateral concessions in comments on environmental regulations; they are likely to take rigid legal stands at the extremes of issues. This posturing hinders agency efforts to strike regulatory compromises because the agency is unable to discern the relative importance of specific issues to the competing interests. Negotiated rulemaking makes it possible to explore and compare the interests of the participants. It makes it possible to identify novel solutions in a manner that cannot take place in the notice and comment context.

### 4. Negotiations Foster Innovation

The threat of judicial review may discourage agencies from developing innovative regulatory proposals. Instead, they may stick to formulas that have survived prior court review, hammering the problem to fit into the mold of the litigation-proven solution. The negotiating table provides an opportunity for innovation.

### 5. Negotiations Lessen The Likelihood Of Litigation

Agency regulations are frequently subjected to expensive and time-consuming judicial review. Once one group files suit, others follow to assure "balance" in the litigation, and to revisit the issues raised in rulemaking, hoping the court will give them "another shot" at the rule. Unfortunately, agency rules almost always survive judicial review intact if they are merely wasteful of resources or ineffective. Judicial proceedings are terribly ill-suited for regulatory fine-tuning.

### 6. Negotiations Avoid Surprises

Finally, regulatory negotiation eliminates a current notice and comment problem -- the "surprise" requirement. Frequently an agency will adopt some new, inappropriate requirement in response to a comment, despite the fact that the requirement was not aired for public review. The public is left with little recourse but to seek agency reconsideration or judicial review of the final rule. In regulatory negotiation, where each provision is fully ventilated, there is little chance of a last minute "surprise" requirement.

## THE DISADVANTAGES OF NEGOTIATED RULEMAKING

There are, of course, disadvantages to regulatory negotiation. It is resource intensive. It can require many of face-to-face meetings. Well-resourced negotiating teams have to be directly involved in day-to-day discussions. Team members have to be absent to some degree from their regular employment.

Private as well as governmental organizations participating in negotiations may have to streamline normal communication and decision making procedures. They must plan for such adjustments in order to be fully responsive to the time pressures created by an intensive negotiation. Any unwillingness to make these adjustments or to commit the necessary resources may hamper the process and can cause distrust among the parties. A failure to do so by the agency involved may defeat the entire effort.

Unfortunately, participants sometimes attempt to take advantage of the consensus nature of negotiations. They may over-reach on issues, stymie the negotiating effort, or simply collect information on their opponents. Such activities are usually quickly obvious to others in the process. But once they surface, these activities can easily scuttle an entire negotiation.

Even where negotiations in which we have participated have reached an impasse, however, they have usually proven worthwhile because of the mutual "education" effect of the process and because of agreements reached up to the time the negotiations ended. In almost every case, these efforts have helped the agency and improved the final rule. They have narrowed the range of issues over which adversaries continued to disagree.

## IS REGULATORY NEGOTIATION COST-EFFECTIVE?

A question frequently asked of the regulatory negotiation process is: does it, in the end, cost more or less?

This is a difficult question to answer. One confounding fact is that negotiations sometimes are not attempted until after parties have battled over certain issues in the courts or in the agencies. In addition, economies may be achieved even in an incomplete negotiation, through a narrowing of issues in dispute, while "successful" negotiations can involve problems not imagined at the outset, thus mushrooming the cost of participation. Nevertheless, the question of comparative efficiencies is inevitable, so I will try to address it.

I believe the most helpful way to do this is to compare the drain on all resources represented by the process of developing a negotiated rule and a formally established rule, and by the likelihood of any resulting litigation and the drain on resources from compliance and enforcement.

A negotiated rule requires a large, up-front investment of resources, clearly more resources than formal rulemaking. Participants must, early on, develop their own options, determine their opponents' positions, support the participation of senior decision makers in the process, and withstand their absence from their regular employment. Interesting, however, because the range of issues in controversy are narrowed, if litigation does occur, the amount, intensity and scope of that litigation is likely to be small. Thus fewer resources are necessary for litiagation.

In addition, once a negotiated rule has been finalized, the resources spent to comply and/or enforce it should be less. Why? Because the regulated parties joined in shaping the regulation. With fewer basic conflicts in the rule there is less stress for the regulated community in coping with the final rule; the agency faces an easier task in enforcing the rule.

Now consider a formal rulemaking. Initial resource commitments, compared to a negotiated rulemaking, are normally low but increase as a rulemaking proceeding matures, as the participants build a full rulemaking record in anticipation of a need to litigate.

The potential for litigation of a formally developed rule is very high, and litigation inevitably involves a wide array of issues, as participants hope the court will afford them another shot at the whole rule. And what usually happens in litigation which successfully attacks a rule? The rule is sent back to the agency for another rulemaking proceeding. Sometimes that effort is followed by more litigation.

I said earlier that the formal rulemaking and litigation process is a poor procedure for fine tuning a rule. Once a rulemaking dispute has been "resolved" by a court, that rule is still likely to have "rough edges" at best, basic flaws at worst. The enforcing agency is likely to have to spend greater resources in enforcement; the regulated community will spend more resources as it wrestles with compliance.

Although it is difficult to predict the efficiencies of a particular negotiated rule versus a particular formal rule, we can say one thing with reasonable certainty. The cost of rules developed through formal rulemaking is likely to be greater for all participants than is the cost of rules produced through negotiation.

## SUGGESTIONS FOR IMPROVEMENTS IN S. 1504

CMA is concerned that S. 1504's detailed specifications for conducting regulatory negotiations (Sections 7 and 8) may interfere with an agency's ability to structure the negotiating committee. The agency must have flexibility and the ability to adapt to a broad range of regulatory problems. Rigid procedural requirements may stifle future procedural innovations that an agency or negotiating committee may want, or need, to try.

For instance, the requirement that all committees have an individual representing the agency would have disrupted the negotiations sponsored by the Occupational Safety and Health

Administration ("OSHA") to develop a labor/industry consensus recommendation for the benzene regulation. In that proceeding OSHA was under a deadline to develop a proposed rule. It was developing the rule on a separate track from the negotiations. OSHA wanted to keep its internal regulatory development on its own schedule separate from that of the negotiations. Although these circumstances are admittedly unusual, other possible reasons for convening negotiating committees without agency representation are foreseeable.

The bill should have more waiver provisions, such as the one currently included in Section 7(c) which allows the agency to expand the size of a negotiated rulemaking committee beyond 25 members. For example, Section 7(a) should allow for a good cause exception where the agency is satisfied that all interests have been assembled and the presence of some emergency requires more immediate action. These provisions would be in keeping with the Administrative Conference's recommendation to "provide substantial flexibility for agencies to adapt negotiation techniques to the circumstances of individual proceedings." 47 Fed. Reg. 30701, 30709 (1982).

CMA also believes the bill should place more emphasis on creating incentives for agencies to initiate regulatory negotiations. The funding mechanism authorized in the bill should help, but if the Committee expects agencies to change long-standing procedural habits, more must be done. One option to consider is requiring agencies to respond within a fixed time to petitions to convene regulatory negotiations based on the considerations set forth in Section 5(a) of the bill. In addition, it may be useful to add a provision which directs the Administrative Conference to explore ways in which agency personnel evaluations and promotion incentives could encourage employees to learn negotiating skills and to employ them in their jobs.

The current incentive for government employees is to demonstrate their skills with formal governmental processes. This would be true for employees who want to advance in government service as well as for those who are building experiences for subsequent employment in the private sector. Agency management personnel need guidance on how to build a new set of incentives for their professional staffs. The Administrative Conference could be asked to provide this guidance.

CMA is also concerned about the importance of an agency's willingness to commit adequate staff and other resources to further an opportunity for success. The agency's resource commitments should be added as a consideration under Section 5(a) of the bill listing factors the agency should consider in determining whether to initiate a negotiating committee. CMA has had some difficulties in proceedings because an agency was either unwilling or unable to devote adequate staff resources to allow efficient and timely operation of the committee. "Adequate resources" should include technical backup for an agency's committee member and possibly colleagues to serve on subgroups established to develop proposals for the committee as a whole.

CMA would like to see greater protection in the legislation for the confidentiality of negotiation communications. The bill assigns each negotiated rulemaking committee the authority to regulate "disclosure of negotiation offers and statements" and requires that meetings of the full committee be held in public. Additionally, Section 8(h) requires that such items as "working papers, drafts" and "other documents" be submitted to the agency, presumably as public documents. CMA is concerned that its own good-faith efforts to reach consensus positions not be misinterpreted as concessions that could be used against CMA by the agency involved, or anyone else. CMA believes this legislation should establish a general presumption that statements and documents related to closed-session activities are confidential and not subject to any public disclosure requirement. The legislation should also follow the recommendation of the Administrative Conference on permitting the committee to conduct business in closed session by unanimous consent of the committee members when necessary to protect confidential information or significantly enhance the likelihood of achieving consensus.

To achieve these goals, Section 8(g) and (h) should be amended to reflect that only the final report and any documents submitted by the committee along with the final report should become part of the agency rulemaking record. All other documents generated in conjunction with the negotiation process should be excluded from the rulemaking record. This provision is necessary to preserve the free exchange of ideas during the negotiation process. If the process breaks down, then none of the documents should be included in the rulemaking record. This would include any minutes or summaries of committee meetings.

Finally, the bill should prohibit regulatory use of confidential information made public through a breach of confidentiality rules. Without such a prohibition, breaches of confidentiality could easily lead to distrust and could threaten the progress of a negotiation. In general, productive exploration of negotiation options will be undercut by a lack of confidentiality.

We are also concerned with the way the bill addresses the notion of consensus. For example, the definition of consensus in Section 4(7) of the bill speaks in terms of "agreement among the interests." This may ask for too much. Often the hammering out of a consensus rule represents little more than a grudging acceptance of the regulatory package when considered as a whole. The operative expression becomes: "I may not like it, but I think I can live with it." For this reason, the word "acceptance" may reflect the likely outcome more accurately than "agreement."

Another important concern that is reflected appropriately in the definition of consensus is the critical need to allow negotiated rulemaking committees to define their rules and to tailor objectives and procedures to the circumstances of each rulemaking effort. For example, the committee in the OSHA MDA proceeding chose to operate on the basis of less than unanimous consent and still achieved a consensus that the negotiating participants were able to sign. There is a need to reflect this same flexibility in other portions of the bill as well.

In sum, CMA believes regulatory negotiation, though not a panacea, may improve many of the rules that come daily from federal agencies.

Although there are parts of the bill that should be improved, Congress should act now to adopt this legislation in response to the Administrative Conference's call for such action six years ago.

Thank you for the opportunity to present CMA's views. I would be pleased to answer your questions.

National Governors' Association

**Gerald L. Baliles**
Governor of Virginia
Chairman

**Raymond C. Scheppach**
Executive Director

STATEMENT
OF

JONATHAN LASH
SECRETARY OF THE
VERMONT AGENCY OF NATURAL RESOURCES

before the

COMMITTEE ON GOVERNMENTAL AFFAIRS
U. S. SENATE

regarding

ENVIRONMENTAL FEDERALISM

September 14, 1988

HALL OF THE STATES · 444 North Capitol Street · Washington, D.C. 20001-1572 · (202) 624-5300

Good morning. My name is Jonathan Lash. I am the secretary of the Vermont Agency of Natural Resources. I am appearing this morning on behalf of the National Governors' Association. Governor Madeleine M. Kunin of Vermont chairs the association's Committee on Energy and Environment. I very much appreciate the opportunity to appear this morning to discuss the role of the states and of the Environmental Protection Agency in protecting health and natural resources.

During most of this nation's history, environmental issues were treated as a private concern, an aspect of property rights. It is only during this century that environmental protection has gradually become a matter to be addressed by government, first at the local level, later at the state level, and finally, at the federal level.

After Earth Day in 1970, Congress began to pass strong, mandatory, environmental regulatory statutes. Although there had been federal clean air and clean water legislation prior to 1970, it was ineffective, based largely upon expectations of state action that were unfulfilled. In the 1970s, the approach changed and, in the words of the United States Supreme Court, "Congress took a stick to the states..."(Train v. Natural Resource Defense Council). In fact, Congress mandated a unique relationship between the states and the newly created Environmental Protection Agency. Minimum environmental standards and basic regulatory requirements were established by federal law and administered by the Environmental Protection Agency, but EPA was authorized to delegate those administrative responsibilities to states that demonstrated the capacity and willingness to carry them out consistent with or more stringently than federal law. This meant that the states served essentially as agents of natural policy. The Congress also agreed to provide major funding for state programs implementing the new statutes.

The new arrangement worked. State and environmental regulatory programs have flourished, and most have accepted the delegation of major program responsibilities ranging from permitting and compliance to monitoring of major sources of air pollution to the regulation of underground storage tanks. In many cases, state standards are significantly more stringent than federal standards. That is certainly true in my own state of Vermont. These more stringent standards may reflect either unique local conditions or strong public sentiment. The authority to set standards more stringent than federal standards is one which we jealously defend and on which we place enormous importance.

Although we have sometimes had occasion to argue over the precise nature and terms of federal environmental requirements, we understand and support the concept that national standards are necessary. There are four reasons for this. First, as becomes ever clearer in this summer of drifting garbage, ozone alerts, forest damage assessments, and global warming, pollution does not observe local, state, or national jurisdictional boundaries. National standards are essential to protect those downwind, downstream, or downeast. Second, environmental compliance costs money, and in the absence of national standards, economic competition exerts enormous pressures on states to lower standards. As I have said, Vermont applies standards more stringent than federal minima in many areas, and I know from hard experience that some industries simply will not enter the state for that reason. I would hasten to add that we think others choose to come to the state because of the very high quality of life that we offer. Nevertheless, economic competition is a real and very significant concern. Federal minimum standards help to protect states against those pressures.

Third, in many cases, the standards apply to industries that operate on a national basis or to products sold in a national market. Consistency from state to state can be important to those industries. Finally, most states simply do not have the resources to address the enormously complex technical questions involved in environmental regulation. We need federal assistance and leadership.

The last two decades have established that environmental protection is an appropriate and essential role for government and that the definition of basic national environmental policy is critical at the federal level.

The federal role should not be limited, however, to setting national standards. A second and crucial responsibility is helping to fund state and local programs that implement federal policy. Federal funding is an essential element of that arrangement. Most states are developing a wide range of user fees, permit charges, and other innovative funding mechanisms to support environmental activities, but states cannot support the full range of programs delegated to them by the federal government.

Federal research on health and environmental effects and on source reduction and emission control technology is also indispensable to state policymakers. Only a few states are able to support significant research efforts, and all of us rely to a large extent on the results of federal research.

Among the most effective environmental protection measures over the last two decades have been federal bans on certain products. DDT and PCB's are a good example. Both have had significant, measurable, positive impacts on our citizens' exposure of these toxic materials. Such bans would have been impossible to implement at a state level. Increasingly, in the future, the federal government will have to take leadership in seeking the substitution of less hazardous materials and production processes for those that create significant, long-term hazards.

Another area of opportunity for very significant federal leadership is in recycling. Congress has already mandated this, but with little effect. Many states are facing a genuine garbage crisis. At meetings of state officials, solid waste is often at the top of our list of concerns. Many states, including Vermont, have developed aggressive and innovative solid waste programs, that emphasize reducing the amount of waste generated and recycling as much waste as possible. As recycling increases throughout the country, a major area of uncertainty is whether markets will be available for recycled materials. The federal government could assure the existence of such markets. This would provide enormous assistance to states and localities as they address solid waste problems. Indeed states could actively seek to purchase products manufactured from recycled materials. This would require some changes in rigid procurement practices, but would yield enormous benefits across the country.

Finally, the federal government must take leadership in addressing international issues. Global warming, acid rain, stratospheric ozone depletion, and ocean pollution, are among the issues that can only be addressed through concerted international action.

Quite frankly, tension has existed between the states and EPA throughout EPA's history. Those are inevitable, but some can be avoided. Under administrator Lee Thomas, EPA has made a real effort to improve the level of consultation with the states. We congratulate him for this, and hope that future administrators will build on the mechanisms he established for federal/state cooperation.

However, in other areas, the relationship has been strained. We have been distressed by the lack of federal leadership with respect to acid rain, air toxics, solid waste, ocean dumping, and a variety of other issues. In many cases, EPA's failure to promulgate standards required by law has forced the states to take action on their own, even recognizing that such action makes less sense at the local level then it does at the federal level. For example, many states have begun to adopt their own toxic air pollution standards because of EPA inaction in complying with the mandates of Section 112 of the Clean Air Act. Eight northeastern states, including Vermont, are proposing gasoline volatility standards designed to reduce hydrocarbon emissions, which now total a hundred thousand tons a year, as one means by which we hope to reduce ozone levels. We are even considering regional tailpipe standards similar to those adopted by California.

New York and New Jersey have recently taken steps to manage hospital waste disposal on their own. A number of states have initiated their own solid waste programs and their own acid rain control programs. In fact, the Northeast has done so in cooperation with the Eastern Canadian Provinces.

Of course, these initiatives can be seen as evidence that action is possible on the state level, and, therefore, unnecessary at the federal level. However, that conclusion would be a mistake. All of the arguments for minimum federal standards apply in these cases. Action by individual states will not be and cannot be wholly effective. It exposes those states to very strong economic pressures. It creates a melange of inconsistent requirements for industries operating in multiple states. We need federal leadership in these areas, and we fear subsequent federal adoption of standards that undercut the programs we have developed.

States have demonstrated a capacity to be innovators. Federal policy should encourage such innovation and highlight it. We are in a far better position than the federal government to implement environmental programs for reasons that are simple and obvious. We are closer and more accessible to the people we regulate. We understand local and regional conditions, and we must be responsive to the people most directly affected by our programs. Those are all factors that help create good government, and our experience in administering these programs simply serves to emphasize the wisdom of Congress in creating the unique arrangement in which federal programs are delegated to state administrators.

My experience has also been that states are often able to get things done more quickly at the local level. This has been particularly true with respect to hazardous waste sites. The federal superfund program addresses problems of great importance and difficulty and of intense public concern. Even rural Vermont has its superfund sites, but the tremendous number of sites nationwide, the complexity of dealing with those sites, and the delicacy of dealing with public concerns about those sites has stretched EPA to capacity and beyond. Unfortunately, designation of a site on the national priority list often delays rather than accelerates action. On more than one occasion, our negotiations with responsible parties have been close to a successful conclusion when announcement that the site would be added to the national priority list has brought activity to a dead standstill. We need to improve mechanisms through which the EPA provides resources to states and allow the states to take the leadership in addressing superfund sites.

Once again, I would like to thank you for the opportunity to appear before the Committee. Environmental protection represents an 18-year-old experiment in federal/state cooperation. I hope that it is an experiment that we can continue to learn from and build upon.

## SENATOR GLENN'S
## QUESTIONS FOR THE RECORD

The Honorable Jonathan Lash

1.

Please explain how the states coordinate with the federal government to make sure that the regulatory burden which they both impose on local governments is not too overwhelming in the aggregate?

2.

Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to state and local governments?

**State of Vermont**

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OFFICE OF THE SECRETARY

Department of Fish and Wildlife
Department of Forests, Parks, and Recreation
Department of Environmental Conservation
State Geologist
Natural Resources Conservation Council

October 11, 1988

The Honorable John Glenn
Chair, Sen. Government
Affairs Committee
United States Senate
Washington, DC 20510-6250

Dear Senator Glenn:

Thank you for your letter of September 23, 1988 and for the opportunity to testify before your committee on September 14, 1988. I am pleased to respond to the questions appended to your letter.

With respect to your first question, I am not aware of any mechanism by which the states systematically coordinate with the Federal Government to limit the burdens imposed on local government, however, we are acutely aware of the problems that may arise when Federal legislation or regulations impose responsibilities on local governments that they are not equipped to fulfill. In most cases, state Environmental officials enforce those requirements as an element in a delegated program. At least in the case of my own state, if we are convinced that the requirements imposed by local government are impractical we communicate that to the E.P.A.

The E.P.A. has for some months been conducting a series of studies of the aggregate cost of new environmental regulations on local governments. Those studies were recently the subject of discussion in the state /E.P.A. Coordinating Committee, which I co-chair with Administrator Thomas.

Regional Offices - Barre/ Essex Jct./ Pittsford/ N. Springfield/ St. Johnsbury

With respect to your second question, with certain exceptions, I am not sure there has been a significant transfer of "clean up and protection" responsibilities from the Federal to State and Local governments. As I noted in my testimony, most Federal Environmental programs were designed to permit delegation of implementation responsibilities to states with adequate programs. I believe that that division of responsibility has worked reasonably well although, some states have been less effective than others in achieving the goals of the major Federal Environment Statutes.

There has been a reduction in Federal financial assistance which has increased the burdens on state and local governments. That has slowed the process of compliance.

In a few areas the E.P.A. has simply failed to fulfill what I understand to be its statuatory responsibilities, two examples are: the regulation of toxic air pollutants and the establishment of emissions and construction standards for solid waste incinerators in landfills. In those areas some states have moved forward independently because our citizens demand effective environmental protection but, we cannot do the job as well or as efficiently acting independently as we could with the full assistance of E.P.A.

It is also important to recognize that while new costs have been imposed on local governments, that is not because of a "transfer of responsibilities". Federal standards generally do not impose regulatory responsibilites on local governments but rather impose standards on activities which local governments, among others, persue. Thus they are not asked to be regulators, but are among the regulated because they carry out a wide range of functions that may have significant impact on the environment including solid waste disposal, sewage treatment and water supply .

None of these activities represents a new mandate for local governments. But, the Environmental Standards applied to those activities, have become more and more stringent as our ability to measure pollution and our understanding of its impacts improved.

One program that was discussed during the course of the September 14th hearing, provides a particularly good example - - the regulation of leaking underground storage tanks.

Development of a federal program to address the problem of leaking underground tanks was essential. The enormous number and wide distribution of underground storage tanks makes them an extremely important source of human exposure to toxic materials. More than half of the population of the country depends on ground water for drinking water supplies, and a single, relatively small tank leak can cause extensive contamination of the water supply for thousands of people. Filling stations and the tanks associated with them are generally located in populated areas, and tank leaks frequently cause direct impacts on nearby homes and businesses when gasoline fumes entering through building foundations create risks of explosion or long-term health damage.

While a few states and counties created their own programs to address leaking underground tanks for all of the reasons detailed in my testimony last week, many did not, nor did the major oil companies or gasoline distributors choose to effectively address the problem. Instead of initiating a program to improve tank monitoring and upgrade existing tanks to avoid leaks, in many instances they simply transferred tank ownership and the associated liabilites to individual dealers. The insurance industry quickly withdrew coverage for environmental damage resulting from leaking underground tanks.

The development of a federal program that affected so many small businesses and local governments inevitably created tensions because it required significant and expensive changes. Local governments were affected not because they were asked to take a role in implementing the program, but because they are involved in the hazardous activity that is being regulated. They are tank owners.

I do not believe that the federal program is excessive, in fact, I believe it is too little and too late. For example, the federal standards will not require that new tanks, when installed, be double-walled and cathodically protected. Clearly, the most effective means to protect from the effect of leaks, a requirement that has been in place in many European countries for 20 years, and has been adopted by several local programs and states, including Vermont.

The financial responsibility requirements are essential in order to assure that funds are available to clean up leaks and compensate third parties.

The problem is that both financial responsibility requirements and other stringent measures with respect to tank installation and monitoring impose significant costs that are particularly difficult for small businesses and small governments to absorb. Vermont faced the propect that most of our 241 small towns would have to abandon their municipal tanks and, in addition, that the small service stations that provide the only convenient source of gasoline in rural areas would cease operations. Our response was to use an increase in the gasoline tax and modest fees on tank owners to pay for a program that:

1. Provides assistance to municipalities and low-volume gasoline retailers to replace older tanks with new double-walled tanks. This will significantly reduce the incidence of leaks.

2. Establishes a clean-up fund to pay most of the cost of clean-up after a deductible amount until private insurance is available.

3. Encourages the development of private insurance coverage.

Enactment of this program simply assures that the costs of protecting society against underground tank leaks will be equitably tranferred to those who derive benefit from undergound tanks: gasoline guyers.

There is no simple rule-of-thumb to determine which functions should be carried out at the federal, state, and local level. Environmental regulation clearly is a governmental function, but we must deal with each issue individually and determine what level of federal, state, and local responsibility is workable in light of the nature of the problem, the scope of the interests affected, and the institutional level at which the solutions must be implemented.

Sincerely,

Jonathan Lash

Jonathan Lash, Secretary
Agency of Natural Resources

cc: Tom Curtis
National Governors' Association

Statement of the
National Association of Towns and Townships
before the
Senate Governmental Affairs Committee
on
the Regulatory Flexibility Act
and
Small Government Responsibility for Environmental Regulations
September 14, 1988

Thank you, Mr. Chairman. My name is Jeffrey Schiff, and I am Executive Director of the National Association of Towns and Townships (NATaT), which represents more than 13,000 units of general purpose local government across the United States. These mostly small, mostly rural communities are typical of the majority of the nation's 39,000 local governments; in fact, 72 percent of general purpose governments in the United States have populations less than 3,000, and fully half have populations under 1,000.

These localities are significantly different from their urban and suburban counterparts in terms of staff and other resources; for the most part, they have no paid staff accountants or lawyers, no professional city managers. There are no environmental engineers on the payroll, (there may not even be a payroll!), and in many cases there is not even a computer. And these places are the overwhelming majority of the localities in the federal-state-local partnership.

## The Need for Realism in Federal Regulations

That is the crux of the problem we are addressing this morning, Mr. Chairman. Since most of America's governments are small and have limited resources, it stands to reason that federal policy developed for state and local governments should be designed with this reality in mind. Instead, legislation and regulations are written with the assumption that there is no difference between a community of 500 and a municipality of 500,000, that their resources are the same. As a result, responsibility for program implementation and funding is given to units of local governments without a realistic assessment of whether they are able to comply.

Thus, current policy creates problems rather than solving them, and we want to solve them. Local officials are anxious to address environmental concerns through regulations that will work. However as currently structured, regulations give us communities which remain unprotected --- because their governments cannot bear the financial, technological, or administrative burden for accomplishing what is mandated. Risk is higher -- because the perception of risk is gone. And local officials, who are mostly volunteers to begin with, are directed by federal law to do what is impossible, or suffer the consequences.

The irony is that the consequences -- from an environmental and a liability standpoint -- increase, and the federal government loses credibility in the process.

I would like to emphasize at the outset that this situation is not limited to the Environmental Protection Agency (EPA), although that is what we are looking at today. It is true that environmental laws and regulations have the highest visibility right now, because of the scope and costs of environmental laws, but the same problem is evident in Department of Labor regulations and civil rights statutes, Justice Department rules, revenue rulings from the Internal Revenue Service, and most federal loan and grant formulas which ignore the reality of local government resources.

## The Promise of Reg Flex

NATaT presented specific information on this situation to the White House last year as part of a project designed to strengthen Regulatory Flexibility Act compliance, and I would ask that a copy of that information package be made a part of the record at this time.

NATaT initiated its Reg Flex project in an effort to decrease regulatory burdens on small governments while at the same time assuring that they had appropriate tools with which to implement federal policy at the local level. As a result of meetings arranged by the White House with the Small Business Administration (SBA) Office of Advocacy and the Office of Management and Budget (OMB), some progress has been made. We have also been working directly with EPA on a similar effort, and we feel there has been very positive action on that front.

In the meantime, the Regulatory Flexibility Act (Reg Flex) continues to be a very valuable, cost-effective tool which can be used throughout the federal government. At the moment, however, it is essentially being ignored, especially with regard to small governments, and we strongly recommend that Reg Flex be enforced and strengthened.

There are several reasons for this recommendation: First, it is impossible for a small organization such as ours to put out all the separate regulatory "fires" which occur in EPA and elsewhere. To address each proposal individually, generate data, research and present appropriate alternatives, is far beyond NATaT's capacity. But even more importantly, Congress has already instructed the regulatory agencies to do that job -- through the Reg Flex Act which places Congress clearly on record as supporting flexibility in rule-making for small governments. In fact, this legislation could not have been better, more sensitive, or more appropriate if local officials had written it themselves.

The Act establishes as a principle of regulatory issuance that agencies should "endeavor to fit regulatory requirements to the scale of the governmental jurisdiction," and to that end *required* them, when publishing any proposed rule, to do both an initial and a final Reg Flex analysis. I won't go into detail on the specific requirements of the legislation, Mr. Chairman, except to say that there is clear direction that the analysis must discuss:

- significant alternatives to the rule which would minimize economic impact;
- different compliance or reporting requirements, or timetables which take into account the resources available to small entities;
- tiering of regulations according to population size;
- simplification of compliance and reporting requirements; and,
- an exemption from coverage of the rule, or any part thereof, for small entities.

When it works, it works fairly well. For example, in a recent primary drinking water proposal published by EPA, which dealt with controlling lead and copper in drinking water, there was a fairly comprehensive Regulatory Flexibility analysis. This analysis pointed out numerous provisions in the proposal which would enhance the ability of small systems to comply. In this instance, EPA's Office of Drinking Water had looked closely at their proposal, recognized it could present problems for small systems, and attempted to provide some alternatives.

Frankly, publication of the actual Reg Flex statement itself may be less important than the process by which the analysis is conducted by federal agencies -- which requires agencies to take a hard look at the implications of their proposals. This process is vital. It requires rulemakers to think ideas through from the point of view of a small government -- Would this approach work? Could they afford to do it? Could they do something else and accomplish the same -- or nearly the same regulatory objective?

If you measure this process against the alternative -- that small governments don't do anything at all because they can't comply -- then the requirements of the Regulatory Flexibility Act become particularly significant.

We are not crying "wolf," here; when a Reg Flex analysis is not done, it can be a disaster. Take a recent Underground Storage Tank (UST) financial responsibility proposal, for example. According to EPA, Congress called for a minimum of $1 million of UST insurance for petroleum marketers. EPA, however, has proposed that this minimum be extended to all petroleum tank owners. Such a requirement will mean that thousands of local governments -- 28,484 of them with populations below 3,000, for example -- which store gasoline for their fire engines and police cars in underground tanks, must somehow come up with at least a million dollars worth of liability insurance or close that tank down.

A million dollars, Mr. Chairman. Many of our small communities could not raise that kind of money if they sold the whole town! Liability insurance for small governments is difficult to get under any circumstances, but insurance against environmental incidents is practically nonexistent. In those rare instances where insurance is available, premiums or deductibles place it far beyond the reach of small town budgets.

I am not here to argue this particular issue, but rather to point out that if a Reg Flex analysis had been done in this case, the agency would have realized what an impossible situation they were creating. The same can be said of many other offices within EPA and other agencies.

To illustrate further, we need to look at one of the major provisions of Reg Flex. Section 601(c) of the Act requires a description of significant alternatives which would accomplish Congressional intent, while at the same time minimizing any significant economic impact of the proposed rule on small governments. Cumulative economic impact of regulations is one of our major concerns.

Consider, again, that most governments are small. Since half of all general purpose governments have less than 1,000 people, it is probably safe to assume that most of them have very limited budgets. We have already discussed the problem of liability insurance, now, let's look at just two recent proposals from the Office of Drinking Water at EPA -- one of the few offices which (to their credit) breaks out cost by system or community size.

The first is one which would remove some of the volatile organic chemicals from drinking water. According to EPA documents, costs would be $3 per household per year in a large system (one serving over 50,000 people); while costs in a small system (serving less than 3,300 people) would be $41 per year, and in a very small system (one serving less than 500 people) the costs would be $91 per year. That's a fairly large difference -- $3 and $91!

Now let's look at proposals recently published to reduce lead in drinking water. Costs for a large system -- one serving more than 50,000 people, would be a total of $10 per year per family. Costs to accomplish the same goals in a small system -- one serving less than 3,300 people -- would be $96 per year per family. And, Mr. Chairman, costs for a very small system - less than 500 people -- *would be $367 per year per family.*

Everyone wants clean water to drink, Mr. Chairman, and I am not here to say that small governments do not want to provide safe, clean drinking water. But these two proposals alone total over $450 per year, per family, in a small community, and this is only one office in one federal agency. EPA issues new regulations almost every day.

One highly-placed EPA official said it best when he pointed out at a recent meeting that small governments are down to their last dollar, and "everyone wants it." Wastewater people want it for their programs, he emphasized, drinking water people want it for monitoring and notification, solid waste people want it for their municipal landfills, underground storage tank people want it for upgrading tanks and insurance, Title III people want it for chemical tracking systems and emergency response -- but there is only *one* dollar.

And every day, local officials of small communities are not only wondering what to do -- they are wondering what on earth is going on up here on the Hill. There must be a better, more realistic way.

## NATaT's Suggestions for Reg Flex

We have several suggestions, Mr. Chairman. First, legislation should be introduced which closes the major loophole in Reg Flex -- that in Sec. 605(b), which provides that an agency head may stipulate, without providing any evidence, that the proposed rule would have no "substantial impact on a significant number of small entities." This option is exercised almost as a matter of course -- often because small governments are not even considered. It is our belief that given the number of small governments, the "significant number" criterion is almost always satisfied; and that the "substantial impact" would emerge if cost impact analyses were done for small government budgets.

There should be a provision in Reg Flex for judicial review. Small governments currently have absolutely no recourse to the most blatant abuse of the Reg Flex provisions. In the absence of judicial review, or perhaps in addition to it, the Office of Management and Budget should be required to develop a Sec. 605(b) certification process -- a standard, government-wide process which would assure Reg Flex compliance by establishing criteria which must be met before OMB approval is given to publication of regulatory proposals.

Such an approach would also ensure that the resources of the federal government would be brought to bear on behalf of America's small communities. It would stimulate creative thinking about new, appropriate technologies, alternative regulatory processes, innovative techniques to accomplish statutory requirements. And that, we believe, is what the Reg Flex Act was meant to do. We applaud the initial goal of Reg Flex, and pledge the ongoing support of our organization for full implementation.

In addition, we would recommend that regular, cumulative cost estimates be developed by each agency to determine the total regulatory burdens of current and proposed regulations which are being placed on small governments under their jurisdiction. This could be accomplished through methodology similar to that used in EPA's recent in-house "Sector Study," initiated by Administrator Lee Thomas, which was done on a sample basis drawing from each EPA operating office. Mr. Thomas took a giant step for small governments with this project, and we commend him highly for his initiative.

We would recommend that the results of such estimates be published by each agency in their twice-yearly regulatory calendar, and that they be provided to the legislative committees of jurisdiction in both the House and Senate.

And Congress should use those estimates when designing new legislation, Mr. Chairman. Cost estimates of proposed legislation should be provided to Congressional committees in advance of markup sessions as part of requested comments. Cumulative cost burdens must be considered whenever new legislation is designed.

Before closing, Mr. Chairman, I would like to mention a NATaT proposal recently presented to EPA which makes suggestions for improving small government regulatory policy apart from and in addition to Reg Flex compliance; the main points of that proposal are attached to this statement. I would hope that the elements in this proposal would serve as a model for other federal agencies, and that these suggestions would find the same level of acceptance and support that they have received from EPA.

Mr. Chairman, we hope you agree that the situation we are discussing today merits further investigation, and that legislation to strengthen the Reg Flex Act would be a good first step. We urge you to make realistic regulations for local governments a high priority as you lead this Commmittee into the 101st Congress, and we look forward to working with you. Thank you again for your support of small town America and its citizens.

I would be happy to answer any questions you may have.

ATTACHMENT

EPA-Small Government Partnership Program

The National Association of Towns and Townships recommends the establishment of an *EPA-Small Government Partnership Program* which would initiate and coordinate agency-wide efforts on behalf of small governments. Such a program would include:

o **Appointment of a Small Government Ombudsman in the Office of the Administrator or the Office of General Counsel, separate from EPA's Small Business Ombudsman** to work as liaison and coordinator for all agency efforts having an impact on small governments, including the technology transfer project and other outreach efforts currently under way within EPA.

o **Official recognition of the important role small governments play** in implementing environmental policy and **support for equal environmental protection for their citizens** through initiation of the following projects. Such efforts would come under the jurisdiction of the Small Government Ombudsman:

-- **Integration of Regulatory Flexibility Act compliance** into all rulemaking activities unless otherwise directed by legislative language. Monitoring of Reg Flex compliance would come under the responsibilities of the Small Government Ombudsman.

-- **Development of alternative technology programs and recommendations for tiered regulations** specifically directed at small governments in population categories below 10,000, below 5,000, and below 1,000.

-- **Institution of a Task Force within the Agency to develop strategies for EPA-small government coordination** throughout the regulatory process. The Task Force would include representatives from state government, EPA regional offices, small governments, and the Office of the Administrator, and would report to the Administrator by the end of the year.

-- **Development and use of an internal education program** for agency personnel -- including regional personnel --on the structure, function and resources of small governments below 10,000.

-- **Design of a computer model data base** containing: (1) a census of services provided by governments under 10,000 in the United States which have environmental implications; and, (2) a program to measure accurately the cost impact of proposed EPA regulations on these governments, so that impact statements could be easily generated.

--**Inclusion by EPA Regional Offices** of at least one small government official in task forces and other consultation processes whenever issues under consideration will affect such governments.

--**Collection of cumulative small-government cost impact data on an ongoing basis,** and factoring such costs into EPA's decisionmaking process.

-- **Sponsorship of a peer-to-peer information-sharing network** between small governments to facilitate the dissemination of technical and other information, in order to make it easier for them to comply with environmental regulations. This network could also have a technology transfer link with EPA.

## SENATOR GLENN'S

## QUESTIONS FOR THE RECORD

### Mr. Jeffrey H. Schiff

1.

Mr. Leiter cited in his testimony some "success stories" in which small businesses used the Regulatory Flexibility Act to their advantage. Are the conditions necessary for successful action by small businesses under the Regulatory Flexibility Act conditions that local governments can fulfill?

2.

Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to local governments?

## QUESTION SUBMITTED BY SENATOR LEVIN

1. At the hearing, there was discussion of the advantages of a more central role for OMB in the implementation and oversight of the Regulatory Flexibility Act. Should OMB have more of a role in the oversight of the Regulatory Flexibility Act? If so, what do you think that role should be?

**National**
**Association of**
**Towns and Townships**

September 30, 1988

Senator John Glenn
Chairman
Senate Committee on
Governmental Affairs
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you very much for your interest in the responsibilities of local governments, and particularly for your interest in the Regulatory Flexibility Act (Reg Flex) and its implications for federal-local government policy decisions. As you requested in your recent letter, we have considered your additional questions and are pleased to submit this information for the record.

With respect to your first question about success stories for small business, and whether conditions of Reg Flex lend themselves equally to small business and small government, our position is that they do not. The sad fact is that small governments do not have nearly the political "clout" that small businesses have, and as a result, small business is much more likely to be addressed in the Reg Flex process.

There are two main areas where small businesses and small governments differ in terms of their influence; first, small business as a group has a much larger resource base -- they can raise a lot more money. With money, data can be generated with which to make a clear case to regulatory policy-makers. Thus, a ready-made tool becomes available to use in the decision-making process.

Small governments, on the other hand, may have a good case but they can't afford to prove it. They cannot "write off" donations as a business expense. They do not have discretionary money to contribute to a "war chest" for legislative or regulatory issues. They cannot fund research to produce alternative suggestions -- and since the National Association of Towns and Townships (NATaT) is a reflection of our constituency (that is to say, we have a very small budget, too), even our association cannot help much in these areas. Since there is no provision for judicial review in this law, small governments are left with only one option -- to let the policymakers know about potential problems, and hope someone is interested enough to come up with a solution.

If the Reg Flex Act were stronger, small governments would not have to importune federal agencies for help; rather regulatory agencies would have a legal -- in addition to a moral -- obligation to write regulations with which small governments could comply.

As to your second question about the benefits or harm of transferring responsibility to local governments, it seems to me that the environment has always been a local responsibility -- that those closest to the problem have always had the responsibility for fixing it; the federal

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responsibility has been to gather information, prioritize problems, and to mobilize communities to address these issues.

In mobilizing corrective efforts, however, it is not enough for the federal government to say in essence, "you must learn to fly, and you must learn to fly in a Lear Jet, and it must be the newest model, and it must be able to carry ten passengers, and it must be painted every six months, and these are the colors it must be painted."

Mr. Chairman, we can barely afford an old, single-engine Piper Cub, and then only if we belong to a club where we can share expenses! Not only that, we may not even be able to get to the airport. If the object is to get a comprehensive view, we may just have to climb the highest tree instead.

If the federal government feels we need to see further -- and we certainly agree it's a good idea, we want to see what's coming, too -- then we need alternatives. You could send us a Lear Jet, or you could say that a Piper is OK. The problem is that in many cases, the federal government is saying it's a Lear Jet or nothing -- and to us, that's the same as saying we have to fly without a plane at all, just flap our arms a lot.

The federal government tends to lose a lot of credibility when it approaches legislation and regulations in this fashion; and rather than solving problems, it creates new ones, as was mentioned in NATaT's testimony. Congress and the administrative agencies cannot simply say, "there, we fixed it," and walk away, when all they have done is floated a fantasy. On the other hand, we do believe, Mr. Chairman, that with a stronger Reg Flex Act and some creativity and specific thinking about the problems facing small communities, federal regulation writers will devise wholly adequate alternatives which are realistic, too.

We would very much like to assist you in helping the federal approach to local governments "get real," and we look forward to working with you and your staff as the next Congress gets under way.

The last question from Senator Levin, about OMB, is a particularly interesting one. NATaT feels strongly that OMB has a role to play, and we made several recommendations to that effect early this year. A copy of our letter to then-Administrator of OMB's Office of Information and Regulatory Affairs, Wendy Gramm, is attached for your information. Although Ms. Gramm was very supportive of our efforts, she unfortunately left OMB shortly after our letter was received; as a result our suggestions have not been addressed.

Briefly, NATaT recommended that OMB issue a federal managment circular supporting the Reg Flex Act, emphasizing that it applies to small governments as well as to small business. In addition, we suggested that OMB require each agency to establish an in-house Reg Flex oversight officer. This senior staff person would coordinate with OMB and the SBA Office of Advocacy to ensure that Reg Flex requirements were met.

NATaT also recommended that OMB design a uniform certification process which would require advance notification before the optional Reg Flex waiver could be implemented (the law's major loophole, Section 605(b), through which agency heads currently leap with abandon). As part of this certification process, agency heads would be required to present their rationale for a waiver decision.

As previously mentioned, Mr. Chairman, small communities essentially have no way to address regulatory rulemaking with the exception of the comment process -- and comments are very easily overridden. Local officials can say "that will not work for us," but the bottom line is that we have no "court of last resort," we have no judicial recourse. Given those limitations, OMB may stand as our only defender. It could bar the way to bad regulations for small governments if it chose to exercise its authority. It could insist that federal agencies obey the law with respect to proper compliance with the Regulatory Flexibility Act.

We hope that OMB will play a role. We hope that Congress will give us judicial review. But in the meantime, here we are, Mr. Chairman, left to the vagaries of the regulatory process. Small governments are, after all, essential partners in the intergovernmental system -- arms of the body politic. Through these arms federal policy extends to the grassroots level. In order to make federal policy work, small governments must be encouraged and protected. Current federal policy discourages them, and puts them at risk.

Again, your interest and support -- and that of Senator Levin -- are greatly appreciated.

With best wishes.

Sincerely,

JSchiff

Jeffrey H. Schiff
Executive Director

JS:an

Enclosure

National
Association of
Towns and Townships

February 3, 1988

Ms. Wendy Lee Gramm
Administrator
Information & Regulatory Affairs
Office of Management and Budget
246 Old Executive Office Building
Washington, D.C. 20503

Dear Ms. Gramm:

On behalf of the NATaT Board of Directors, I thank you for your willingness to meet with us recently to discuss ways in which we can improve the application of the Regulatory Flexibility Act (RFA) to benefit small governments. We appreciate your thoughts and your sincerity in ensuring government-wide compliance with the RFA's requirements.

Since our meeting at the White House, we have taken several steps to improve communications with government agencies with regard to RFA. Last week we met with Frank Swain and have begun to establish a working partnership on individual regulatory issues as well as a better understanding of small government issues among the SBA Office of Advocacy staff. We are delighted by Mr. Swain's responsiveness and are greatly encouraged by what can be accomplished through a strong partnership effort between NATaT and SBA..

In addition to these first steps, we are convinced of the need to establish a uniform policy on RFA, particularly with respect to agency use of the RFA certification process. We believe that a federal management circular, or some other appropriate administrative/management tool, could improve the way in which federal agencies manage their internal application of RFA as part of their regulatory development process. Such a central management device could give your office more influence over federal agency compliance with the law.

Specifically, we would recommend that your office issue a federal management circular to emphasize the fact that small governments are "small entities" under the language of the RFA, and as such must receive equal consideration during the rulemaking process.

In addition, we would suggest that several specific sections of the RFA be restated and reinforced; for example, Sections 601 and 603, which would permit "tiered" regulations. A central policy should be established which requires agencies to consider the effect of their regulations on governments according to their size

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and thus, their capacity. We would suggest the following population categories for individual regulatory consideration:

governments below 5,000
between 5,000 - 10,000
10,001 - 25,000
25,001 and above.

Clearly, a government with a population of 3,000 does not have the same capacity as a government of 10,000--and neither have the same resources in terms of equipment, expertise or personnel as a government serving 25,000 or more. There are vast differences in the ability of local governments to respond realistically to legislative intent behind federal regulations.

By the same token, Sec. 603 in its entirety should be underscored, since it is our belief that most regulatory agencies are unfamiliar with these provisions. Increased compliance by regulatory agencies with this section would greatly improve compliance at the local level of government since compliance can be achieved through a variety of more realistic procedural approaches. Among other things, Sec. 603 specifically directs that each initial regulatory flexibility analysis contain "a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply (emphasis added)."

This is a necessary first step in any regulatory agenda. As it stands now, an agency may address small businesses in their reg flex analysis while ignoring small governments entirely.

Further, Sec 603 requires "a description of the projected reporting, record keeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record."

This fits in very nicely with OMB's Paperwork Reduction Act responsibilities, and in addition would force agencies to recognize the reality of local government. Since 50 percent of all general purpose governments nationwide represent populations below 1,000, it is clear that the majority of local governments operate without paid staff or any kind of sophisticated equipment or expertise. In the process of writing complex reporting, record keeping and other compliance requirements, it would be wise to keep this fact in mind; otherwise, regulations will be written only for the small minority of governments which can implement them.

The National Association of Towns and Townships would also recommend that the circular require each agency to name a senior agency staff person to oversee the agency's implementation of RFA. This person would coordinate and work with your office and the SBA Office of Advocacy to ensure that the agency is adhering to the requirements of RFA and this proposed circular.

Another NATaT recommendation would be to require each agency to go well beyond current efforts to seek comments on proposed agency rules from the smallest of governments. Requesting comments through the Federal Register is not enough since for the most part, small governments never see the document. Agencies should be held accountable for a much larger effort to seek small community views. Agencies should be required to devise a plan, and to file that plan with the OMB Office of Information and Regulatory Affairs.

At a minimum, NATaT recommends strong administrative action to minimize the use of the major loophole in the Reg Flex Act which allows agencies essentially to ignore the requirements of the Act with a simple statement from an agency head. A uniform process should be detailed for the Sec. 605 (b) certification, which can be made now by simply certifying in the final rule that the proposal has "no significant impact on a substantial number of small entities." Under this section as currently interpreted, agencies can pay lip service to the Act while completely disregarding the intent of this legislation.

This process should require that OMB's Office of Information and Regulatory Affairs be notified in advance of agency intent to waive a reg flex analysis and the agency should be required to state how it arrived at that decision. OMB should restate the current requirement that an explanatory statement be published along with the final rule, and require supporting data when appropriate--in order to substantiate the fact that an agency has made more than a perfunctory investigation into the impact of the rule on small governments.

In closing, we believe that an OMB circular, or similar tool, could greatly improve agency implementation of the RFA. As with A-102 and other management documents, the agencies would have an established procedure to follow. If agencies became too lax, your office would then have a management document to force them to toe the line. We recognize that this document would not give OMB the same authority as the Paperwork Reduction Act; nevertheless, it would greatly influence agency compliance and could, in some cases, give OMB and the SBA an important enforcement tool.

We encourage you to give serious consideration to our recommendation, and we look forward to exploring our ideas with you and your staff.

Sincerely,

Jeffrey H. Schiff
Executive Director

JHS:vb

cc: Gwen King
Frank Swain

**WARREN TOWNSHIP**
Route 1, Box 17
Fleming, Ohio 45729

TESTIMONY OF

JOAN L. BEARDMORE
TOWNSHIP CLERK

OF
WARREN TOWNSHIP
WASHINGTON COUNTY, OHIO

BEFORE THE
UNITED STATES SENATE
GOVERNMENTAL AFFAIRS COMMITTEE

SEPTEMBER 14, 1988

## INTRODUCTION

Mr. Chairman and members of the committee, my name is Joan L. Beardmore. I am serving my ninth year as clerk of Warren Township, Washington County, Ohio. I am a member of the Board of Directors of the Ohio Township Association and a member of the National Association of Towns and Townships. On behalf of all the small governments throughout the United States of America, I appreciate the opportunity to share my concerns about the Regulatory Flexibility Act with you.

The Regulatory Flexibility Act is a tool which is needed in our country to protect small governments from federal mandates that are many times impossible for them to meet. I know when decisions are made in Washington you have the interest of the American people at heart. However, I know you will agree that it is easier for a large government, with all their staff, computers and other means, to comply with the federal mandates than a small government such as Warren Township.

## UNDERGROUND STOREAGE TANKS

The United States Environmental Protection Agency has published its rules concerning financial responsibility for damage caused by pollution from underground storage tanks containing petroleum products. This financial responsibility applies to all entities who own or operate an underground storage tank.

Warren Township has five underground storage tanks for gasoline and diesel fuel storage. These tanks are a various locations through out the township. These locations are vitally important to help provide emergency services to the 3600 township residents and clear safe roads during the winter months when snow removal is so important.

If these underground storage tanks were not available to our road department and fire department we would have to purchase our gasoline and diesel fuel at our small independent dealers. If the township cannot meet the regulations to have underground storage tanks there is a great possibility that neither will the small independent dealers. That would require all our township vehicles to drive to Marietta, Ohio, which would be a twenty mile round trip for every tank of fuel needed, plus the added cost of fuel and the traveling time.

Warren Township is currently a member of the Ohio Township Association Risk Management Association (insurance pooling) where we have a maximum of fifty thousand dollars for pollution liability coverage. I asked our local agent to see if he could find our township additional coverage for our underground storage tank pollution liability. At this time he has not been able to find a company to provide such coverage and he felt that if he did the premium would be extremely high. His comment was "you can usually insure anything when the fragrance of the premium is greater than the stench of the risk." I feel the stench of our risk is much greater that our budget can afford. At this point in time, there is no way Warren Township can secure the required one million dollars required insurance coverage for our five underground storage tanks.

Warren Township could replace the five underground storage tanks to help lessen the danger of leakage but we are looking at a cost of approximately ten thousand dollars out of a budget that has already reached its limit.

The budget for Warren Township in 1988 was three hundred seventy-two thousand dollars and of that amount forty-six percent (one hundred seventy-two thousand dollars) was for the road department. So far this year only half of our fifty-three miles of roads have been repaired due to a lack of funds. The township trustees added two and one half tenths of a mill to the property taxes in Warren Township in 1988 for road repair with an another eight tenths being added for 1989. The trustees enacted an additional five dollar motor vehicle license tax for 1989 but a referendum petition has been filed and will be on the ballot in November 1988. Even with all the added revenues there will still not be money available for extremely high insurance premiums. The need for the additional taxes is due to decreasing property valuation over the past several years, the loss of General Revenue Sharing and rising cost of labor and materials.

## SUPERFUND AMENDMENTS AND REAUTHORIZATION ACT OF 1986

As clerk of Warren Township I make an effort to be familiar with all the new regulations that are passed both in Washington D.C. and Columbus, Ohio. I find that the Superfund Amendments and Reauthorization Act is a real concern for most of the townships in Ohio that they are not able to comply with the regulations. Reading the rules and regulations and trying to understand them is one thing but having hands on experience is the best way to evaluate the situtation.

I recently spent an afternoon with Jeffrey Knowlton, the fire chief of the Warren Township Fire Department going through the requirements of the Superfund Amendments and Reauthorization Act (SARA Title III) and how it effects our fire department. The fire chief showed me the large books of Material Safety Data Sheets (MSDS) which is constantly up-dated from the various companies in our township. Each time there is additional information about one of the hazard materials that is stored in our township the companies must send an up-dated MSDS to the fire department. These sheets must be kept up todate in the files at the fire department so current information is available to the firemen if they are responding to a hazardous materials emergency.

SARA Title III requires a minimum of twenty-four hours a year training on hazardous materials by every member of the fire department This is in addition to the required training hours set by the State of Ohio. Maybe this doesn't sound all that difficult but remember we are talking volunteer personnel who are giving of their personal time to help serve the public. Besides the training hours the fire department is also responsible for emergency calls, equipment and building upkeep and fund raising events. The majority of the fire departments in the State of Ohio are volunteers working with a very small budget. This means these people are giving up family time as well as their own leisure time to help provide fire protection to our township residents. It is getting to the point that they don't want to be told they have to give up more of their time for training.

On August 1, 1988 Mr. Knowlton presented a letter to the Board of Warren Townships expressing his concern about the future of the fire department. Part of his letter read.." the newest and possibly the most devasting threat to the existence of volunteers is regulations. One example is the new SARA Title III legislation. This law requires many training hours to be completed for anyone responding to a hazardous material incident. To do this in addition to fire and EMS training is almost impossible. Then there are the new NFPA safety standards. Even though I agree with these standards, they can be intimidating to many volunteers and the pressure there is to comply." He went on to remind the board of trustees that it is their responsibility to provide fire protection to the residents of Warren Township and that they must provide the safest possible environment for the fire personnel and the residents. He feels the future of the fire department is in jeopardy. Is a paid fire department going to be necessary to comply with all the paper work and the training requirements? That will mean an increased budget which will take a substantial increase in property taxes to meet.

Mr. Knowlton's future plans do not include service as fire chief for our volunteer fire department after December 31, 1988. He cites too much time, too many regulations and the added responsibilites as the reasons for his decision. We have qualified personel in our fire department but will there be someone who will want to take on the responsibilites that have haunted Mr. Knowlton these past years?

## Closing Statement

As you can see, just two of the federal mandates have placed a tremendous burden on Warren Township. The regulations are unrealistic for a small government to comply. As it stands now, federal agencies have ignored the Regulatory Flexibility Act as far as small governments are concerned. This leaves the officials of small governments to accept tremendous liability while attempting to choose between either complying with the regulations, which I have stated are clearly impossible, or disobeying the law. The Regulatory Flexibility Act has provided a way to help overcome that problem.

Just as Mr. Knowlton stated that he agreed with the standards set, I also agree that these regulations are for the betterment of our country. But somewhere, someone has to use "common sense" to make these regulations apply where it is possible to comply.

Mr. Chairman and members of the Committee, I urge you to look into the compliance of the Regulatory Flexibility Act by various federal agencies. I thank you on behalf of the National Association of Towns and Townships, the Ohio Townships Association, and Warren Township, for your time to listen to my concerns about the regulations handed down to small governments from the federal government.

**WARREN TOWNSHIP**
Route 1, Box 17
Fleming, Ohio 45729

October 18, 1988

The Honorable John Glenn
United States Senate
Committee on Governmental Affairs
Washington D.C. 20510-6250

Dear Mr. Glenn:

I would like to thank you for allowing me to participate in your senate hearing on the Regulatory Flexible Act on September 14, 1988. I appreciated the time your committee spent listening to the problems that small governments are experiencing due to federal regulations.

I am enclosing my answer to the additional question concerning the environmental clean-up and protection since the transfer of responsibilities to the local governments. I hope this will help your committee in their investigation.

Thank you again for the privilege to testify before your committee on governmental affairs.

Yours truly,

Joan L. Beardmore

Joan L. Beardmore
Township Clerk

jlb

enclosure

## SENATOR GLENN'S
## QUESTIONS FOR THE RECORD

Mrs. Joan L. Beardmore

1.

Please use your experience as clerk of Warren township to comment on whether actual environmental clean-up and protection has benefited or been harmed by the transfer of responsibilities to local governments?

Answer:

The benefits of the environmental clean-up and protection has been that the local government officials are closer to the situtation because they live in the area and their interest would be greater.

The problems caused by the transfer of the responsibilities to local governments are the financial responsibilities for providing the personnel, equipment, etc. for immediate clean-up. The fire chief is concerned about needing additional equipment if a spill was to occur on one of our state routes and who would pay these people doing the work until money could be collected from the company who had the spill. The budgets of townships could not handle providing such services.

We are working closely with the Washington County Diaster Services to use all the services available should such an emergency occur but the potential is there for a situtation that would be devastating to our township.

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS

# "REGULATORY REFORM: FEDERALISM AND THE REGULATORY FLEXIBILITY ACT"

TESTIMONY
OF
JEFFREY L. LEITER
COLLIER, SHANNON, RILL & SCOTT

SEPTEMBER 14, 1988
WASHIGNTON, D.C.

Thank you. My name is Jeffrey L. Leiter. I am a member of the Washington, D.C. law firm of Collier, Shannon, Rill & Scott. I appear today on behalf of small businesses and their trade associations. As a small business representative, I appreciate this opportunity to discuss the current allocations of responsibility for environmental regulations. While our firm represents small businesses and trade associations across the broad spectrum of economic activity in this country, I would like to confine my testimony to examples and experiences encountered during my work for two gasoline marketing organizations -- the Society of Independent Gasoline Marketers of America ("SIGMA") and the National Association of Convenience Stores ("NACS") -- on Federal environmental regulations over the last eight and one-half years.

## Introduction

At the outset, it is unnecessary to explain to the Committee the importance of small businesses to this country's economy. According to Small Business Administration ("SBA") data, almost 90 percent of the businesses in the United States are "small." While definitions of a "small business" will vary, a constant is that the financial resources available to small businesses for complying with environmental regulations are more limited than those available to larger companies. Small businesses naturally are concerned whether environmental compliance costs can be passed on to their customers in the form of higher prices. While "rational" economic theory would suggest that prices in an industry should rise to reflect the average cost of all producers, such increases often take time and frequently are inhibited by competition or consumer resistance. Moreover, increases in environmental costs experienced by small businesses can be greater than industry averages. Please do not misunderstand me. Small businesses do not seek to avoid their responsibilities for compliance with environmental regulations. Instead, they need assurances that there actually will be incremental environmental benefits for each dollar they spend.

In addition to the significant economic impacts of environmental regulations on small businesses, the Committee should keep in mind that small businesses have limited staffs to respond to environmental rulemakings and regulations. They generally do not have neither in-house lawyers to read the Federal Register nor engineers to implement the often complex rules. Further, small businesses must divert considerable time to paperwork and recordkeeping requirements under the environmental regulations.

## Responsibilities and Burdens Placed on Small Businesses by Environmental Regulations

The Environmental Protection Agency ("EPA") has identified some 85 recent and forthcoming environmental regulations that will become effective over the next five years and that will affect small businesses. This list of 85 environmental regulations, taken as a whole, would overwhelm any business. However, it is important to keep in mind that a particular small business or industry generally will be affected directly by a small number of these rules. For example, take SIGMA and NACS members for whom "LUST" has become "SEX." By the way, "LUST" is "Leaking Underground Storage Tanks" and SEX is "Soaring Environmental Exposures." The principal environmental regulations that will affect gasoline retail outlets over the next five years are the technical standards for underground storage tanks issued yesterday by EPA and the financial responsibility requirements for tank owners and operators that are expected to be promulgated at the end of this month. In addition, gasoline retailers are being required in certain areas of the country not attaining national air quality standards for ozone to install devices -- commonly only known as "Stage II" -- on gasoline pump hoses to capture vehicle refueling emissions. Pending Clean Air Act legislation could expand this Stage II requirement. Other environmental concerns include the allowable lead content in gasoline, fuel volatility, diesel fuel standards, used oil and solvent management, disposal of hazardous wastes, Class V underground injection wells under the Safe Drinking Water

Act, stormwater runoff permits, and compliance with the community right-to-know provisions under Title III of the Superfund Amendments and Reauthorizations Act of 1986 ("SARA").

I offer this brief description of environmental regulations -- or "SEX" -- to the Committee to highlight several points. First, for some small businesses, such as my gasoline marketer clients, there is significant regulatory activity "on the plate." Thus, in analyzing the effects of a particular environmental regulation on small businesses, it is incumbent on EPA to have a clear understanding that its new rule does not occur in a "regulatory vacuum." The regulatory "overlaps" need to be considered. For example, if Congress, as part of Clean Air Act amendments, mandates the installation of stationary Stage II vapor recovery devices at retail gasoline outlets in ozone non-attainment areas, then why can't the timing of such installations be coordinated with tank upgrades and replacements under the Agency's just promulgated underground storage tank rules? It is an unnecessary waste of scarce resources to force a gasoline marketer to "break the concrete" twice in a relatively short period of time.

Second, simply learning how to comply with environmental requirements is a time-consuming task for any business, but particularly for small businesses. Moreover, moving up the "learning curve" can be expensive for small businesses. All too often, there is a significant, initial period of confusion on the part of small businesses when new regulations are issued. In many instances, the small business learns of its responsibilities at the "11th hour" or, sometimes, after compliance deadlines have passed.

Third, consequential effects of environmental regulations on small businesses are often overlooked. By this, the costs of environmental compliance do not analyze the problems small businesses encounter in generating the capital necessary for equipment and maintenance. For many small businesses, such as gasoline marketers, their real estate is one, if not the greatest, asset in the business. A tank leak today is the fastest way to impair the value of that real estate. However, because of the current legislative, regulatory, and judicial "climate," lending institutions have become extremely leary of making loans for environmental compliance where the property is held as security. Stringent loan conditions, such as substitution of collateral and acceleration upon the occurrence of an environmental impairment, are common. Moreover, lending institutions have become increasingly concerned with loans for environmental compliance which they interpret as non-income producing activities. The result is a shorter payback period for the note. Then, the lenders ask to be named as additional insured on the borrower's comprehensive general liability insurance policies. However, with some exceptions, most small businesses today have difficulties in obtaining pollution liability coverage as part of these policies.

Because my time is limited, I do not wish to overdramatize the responsibilities and burdens placed on small businesses by environmental regulations. However, from my brief discussion, I hope it is evident to the Committee that the need for environmental regulations to protect human health and the environment must take in to account the abilities -- both technical and economic -- of small entities to comply with the rules without becoming overburdened and non-competitive by the responsibilities and costs.

I should take a brief moment to mention that many small businesses with their entrepreneural spirit and talents do view environmental regulations as a possible business opportunity. For example, I am aware of several gasoline marketers, upset with the costs and availability of underground storage tank testers and contractors, have started their own companies to handle their tank management programs for their tanks, as well as those of their customers.

## Comparison with the Responsibilities and Burdens Placed on Small Governments by Environmental Regulations

My colleagues on the panel this morning have done an excellent job of explaining the problems that environmental regulations create for State and local governments, particularly municipalities. The range of environmental regulations, similar to small businesses, may create compliance difficulties for the smaller communities. Many municipalties, because of their structure and demand for services, have a limited "margin" for expanding their financial obligations caused by ennvironmental compliances.

While it is obvious that small governmental units are regulated entities under many environmental regulations, of particular concern to many small businesses is that these governmental units increasingly are being called upon to enforce Federal environmental regulations. While logic dictates that the unit of government closest to the problem should be in the best place to enforce, it is not often the case. For example, EPA's underground storage tank program envisions that the States substitute tank regulatory programs, with EPA's approval, for the Federal rules. In essence, the new tank rules will be enforced and administered by the some 3,000 counties across the United States. However, consistency in application and interpretation of the rules becomes problematic and creates additional compliance burdens on tank owners and operators, particularly small businesses with multiple locations.

As another example, the material safety data sheet and routine inventory reporting under sections 311 and 312 of SARA Title III require submission to State and local entities, including the local fire department with jurisdiction over the reporting facility. While EPA properly is phasing-in these reporting requirements to reduce the paperwork management burdens on these State and local entities, such submissions nevertheless have taxed many local fire departments, especially those that are volunteer squads.

## Regulatory Flexibility Act — Needed for Environmental Regulation

I assume that the SBA and EPA witnesses will describe the requirements and operation of the Regulatory Flexibility Act ("RFA" or "Act"). While there always is room for improvement, EPA probably has done the best job in the Executive Branch of incorporating regulatory flexibility analyses in its rulemaking process. In most cases, other departments and agencies routinely resist or avoid considering small business impacts, arguing that their rulemakings are exempt from RFA's requirements.

Let me take a few moments to discuss some of the successes small businesses have had under the Act at EPA. Because final tank rules were issued only yesterday by EPA, it is timely to point to the Agency's underground storage tank program. Congress, in its 1984 amendments to the Resource Conservation and Recovery Act, directed EPA to promulgate rules to prevent, detect, and correct leaks from underground storage tanks. This regulatory program also is to include a demonstration of financial responsibility for leak clean-ups and third-party claims. Congress directed EPA to consider the "technical capabilities" of small businesses in issuing these rules.

EPA's Office of Underground Storage Tanks, in developing the technical standards for underground storage tanks, conducted extensive regulatory flexibility analyses. Agency staff and contractors conducted substantial "outreach" to the regulated community, including small businesses, to obtain data and other information. Based upon these analyses, EPA was able to make thorough and thoughtful regulatory judgments prior to the April 1987 proposal of the tank rules. The public comment period that followed demonstrated that the up-front analyses, which included small businesses impacts, resulted in final rules that protect human health and the environment and give small businesses considerable flexibility. While it is too early to heap praise on the underground storage tank program, particularly when it remains to be seen how many small businesses, particularly gasoline marketers, may close because of the rules, the "lesson" from the program is that rules that protect human health and the environment minimize impacts on and small businesses are not mutually exclusive. The success of the tank technical standards, much like their development, will hinge on whether small businesses, small governments, EPA, SBA, other tank owners and operators, and environmentalists can work together.

EPA has not yet issued its final financial responsibility requirements for owners and operators of underground storage tanks. However, similar to the tank technical standards, the Agency has done an excellent job of considering the small business impacts of these rules, particularly in light of the general unavailability of tank leak insurance. As a result of its regulatory flexibility analyses and its outreach efforts, the Agency likely will phase-in compliance with its final tank financial responsibility rules over a 24-month period. This lead time should permit small businesses and small governments -- both of whom are tank owners and operators -- to develop appropriate financial assurance mechanisms.

Another area of success at EPA under the RFA has been the Title III rules. For example, under the sections 311 and 312 reporting requirements for material safety sheets and routine inventories, EPA is continuing to assess a permanent threshold that would result in less paperwork being generated by small businesses and received and managed by State and local entities. The Agency is expected to initiate a rulemaking on this subject in the near future.

Small manufacturing concerns are subject to the toxic chemical release reporting under section 313 of Title III. Based upon extensive discussions with small business groups, SBA's Office of Advocacy, and EPA's Small Business Ombudsman, the Agency modified its section 313 reporting form to permit small businesses to report in ranges rather than to go through extensive release calculations. Thus, costs and burdens were reduced. I should add that EPA estimates that the typical compliance costs under Title III to small businesses is $10,000 per year. Such costs are not insignificant and militate that the Agency continue to seek ways to minimize costs to small businesses under its community right-to-know program.

Where the regulatory flexibility process and analyses have broken down at EPA, there appears to be several recurring reasons. First, in some instances, the regulatory flexibility analysis has been an "after thought." The appropriate analysis of small business impacts takes place subsequent to the issuance of a notice of proposed rulemaking. While such an analysis is completed before the rule is finalized, the "late start" comes after EPA staff become "wedded" to a particular regulatory approach, thereby foreclosing the appropriate consideration of regulatory alternatives, including those that will not have adverse effects on small businesses.

In many instances, EPA staff do not have an appreciation for the "pressures" -- economic and otherwise -- on small businesses. This shortsightedness, while not intended, largely is the result of a failure to perform outreach to small businesses and their trade associations early in the regulatory process. When such outreach is not conducted, small businesses typically assume a reactive posture with the Agency. EPA staff then accuse small business representatives of "crying wolf." They accuse us of repeating the same "chorus" -- that is, small businesses will close -- when they do not see such results in practice. More disturbing, is the attitude of some Agency staff that many small businesses would go out of business even in the absence of the particular environmental regulation or that these small businesses should not continue to exist. Unfortunately, such personal opinions often find their way into rules and EPA enforcement actions.

There also is a problem with the consistency of regulatory flexibility analyses at EPA. While the methodology and the quality of data have improved, improvement is necessary. For example, the costs of environmental regulations typically are annualized. However, such costs are annualized over the expected lifetime of a particular environmental investment, rather than on the basis of a small business' ability to generate and recover the compliance costs. For example, while it may be appropriate to analyze the costs of an underground storage tank replacement over the lifetime of a tank and its piping (e.g., 30 years), such annualized costs do not reflect that the small business tank owner must go into a lending institution and obtain tank financing pegged over a three to five year payback. Stated differently, EPA's regulatory flexibility analyses should consider the abilities of small businesses to generate and recover environmental compliance costs over a period of time tied to business realities.

In addition, the regulatory flexibility analyses do not typically include a consideration of regulatory overlaps and other environmental compliance costs facing small businesses at the same time. It is easy to argue that small businesses might not be harmed by a particular environmental regulation; however, such a narrow view conveniently ignores the real world.

As a final general matter, EPA needs to remain open-minded about regulatory alternatives and expectations of environmental benefits. As to regulatory alternatives, regulatory flexibility analyses should include a discussion of longer phase-in periods or exemptions for small businesses. As to environmental benefits, many of the environmental statutes create unreasonable expectations as to environmental results. Congress has set unreasonable deadlines too many times to force technology or to prod the regulated community to act on a more timely basis. This need to get the country moving on environmental protection cannot be argued with. However, today EPA needs to address in its rulemakings how to obtain the largest environmental benefit in the shortest period of time. However, the key is sustaining such progress. The tank rules demonstrate my point. The five-year phase-in of leak detection for existing tanks recognizes that tanks cannot be retrofitted overnight. Moreover, it addresses the tanks more likely to leak first, while, at the same time, not foreclosing further developments in leak detection technology.

Similarly, the ability to detect hydrocarbons in soil and ground water far exceeds the ability to clean it up. Thus, it would have been unreasonable for EPA to mandate tank leak clean-ups nationwide to some unattainable standard that would approximate detection levels. The goal properly should be remedying as many contaminated sites as quickly and as completely as possible, resulting in significant progress and environmental benefits.

Based upon my experiences, small businesses' regulatory successes at EPA have occurred through the joint efforts of EPA regulatory staff, EPA's Small Business Ombudsman, SBA's Office of Advocacy, and small business representatives. This "coalition" building, particularly in the rule development phase has been critical to EPA's obtaining good data and issuing good rules. The Agency cannot regulate without information, including data from small businesses. Accordingly, this informal working group process has enabled EPA to do its job better. However, there are limitations. Small business groups have small staffs and tight resources which can curtail their participation in the regulatory process or their ability to survey small business members for information needed by EPA.

The problems of small governments in bringing their problems to EPA are similar. There are just so many fires that one can fight at a single time. Small governments and their associations historically have had "bigger fish to fry." Hopefully, EPA will more carefully assess impacts on small governments in its regulatory flexibility analyses. Such analyses should include the cumulative costs of the regulations -- that is, not only compliance costs, but also enforcement costs where the governmental unit has that responsibility.

## Improving the Effectiveness of the RFA

RFA's implementation and effectiveness can be improved in several ways. First, EPA typically employs a "work group" approach in its rule development. By this, the various offices and program elements within the Agency will sit in on the deliberations of the office responsible for the issuance of the rule. This enables the regulators to consider effects on other EPA rules and consistency in implementation.

EPA should consider establishing external work groups in the rule development phase (i.e. prior to the issuance of a notice of proposal rulemaking) to obtain broader input on the rules. Small businesses and small governments should be included in such work groups.

Similarly, the Agency should expand its outreach efforts, including education and training. Such programs and materials could help to reduce compliance expenses to small businesses.

Other actions that could be taken by EPA flow from my previous discussion. That is, policy initiatives that consider regulatory alternatives, such as longer phase-ins, automatically should be considered. Further, additional up front research and analyses also should be mandated before environmental rules are proposed.

One area I am not certain EPA can get a handle on in the short-term is developing financial incentives as part of its rules for small businesses. Perhaps, the initial answer lies in "bundling" compliance responsibilities and burdens. For example, the use of class permits, obtained by trade associations, could reduce compliance costs and stimulate compliance action.

## Changes in Current Law

As I noted at outset, many departments and agencies have resisted or avoided their responsibilities under the Act. Further, there appears to be little judicial review of the RFA. Accordingly, the Committee might consider amendments to the Act that will make it difficult for departments and agencies to hide behind their RFA certification decisions. The Act should be amended to provide for judicial review to ensure that appropriate regulatory flexibility analyses are being performed and that the interests of small businesses and small governments are being considered. Informed rulemakings are better not only for small entities, but for everyone.

I appreciate this opportunity to present my views. I will be happy to respond to any questions the Committee may have.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

# TESTIMONY OF

HONORABLE FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

U.S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

SEPTEMBER 14, 1988

Good morning Mr. Chairman: It is a pleasure to appear before your committee. The issue before the Committee this morning -- regulatory policy and its effect on small businesses and other small entities -- is a subject of great interest and concern to me. The views presented in my testimony are my own and do not necessarily represent those of the Administration.

This is certainly not the first time that the impact of government decision-making on the public has been explored, nor is it likely to be the last. The focus may change-- should we only be looking at the Federal Government? or should we be focusing on state and local governments? -- but the necessity for repeated examination of the continually shifting relationship between the government and its people remains.

I come to this Committee with what I believe is a unique perspective on this topic. I have served as the Chief Counsel for the Office of Advocacy of the Small Business Administration since 1981. The statute that created this Office charges me with representing the views and interests of small business before other agencies of the government, as well as the Congress, and requires my office to collect and analyze economic data on the state of small business. One of my main responsibilities is to monitor and report to the Congress and the President on the implementation of the Regulatory Flexibility Act (RFA or the Act).

The Regulatory Flexibility Act, which took effect on January 1, 1981, requires federal agencies to analyze the impact of their proposed regulations on small entities and, whenever possible, to adopt less burdensome regulatory alternatives which meet the legislative objectives of the underlying substantive statute. It is a procedural act which, in conjunction with the Administrative Procedure Act, instructs agencies on how to issue regulations affecting small entities. The legislation, as originally introduced, applied only to small businesses, and therefore was referred to the House and Senate Small Business Committees. However, during committee consideration of the bills, other small entities, including small governmental jurisdictions, were included in the legislation.

Based on this legislative history and the fact that the RFA monitoring and reporting function were placed in the Small Business Administration, Congress has, perhaps unintentionally, signaled that the greatest emphasis should be placed on the small business perspective.

The difference in the impact of federal regulation on small businesses and small governmental jurisdictions is important to recognize. In many instances small governmental jurisdictions are regulated by the Federal Government in the same way as are small businesses; an example is the area of solid waste disposal. Quite often, however, the Federal Government relies on small governmental jurisdictions to be the implementors of law. Although this latter responsibility makes many demands on the resources of small governmental jurisdictions, these implementing functions may not create the kind of burden that the RFA anticipates in its analysis requirements.

## THE REGULATORY FLEXIBILITY ACT

The RFA is based on the premise that small entities are disproportionately disadvantaged by federal regulation compared to their larger counterparts. The costs of complying with a particular regulation -- measured in staff time, direct compliance costs, recordkeeping, outside expertise and other costs -- might be roughly the same in dollar terms for a company with $1 million in sales as a company with $10 million in sales. However, the impact on firm viability may be dramatically different since the smaller firm will have fewer units of output over which to spread this added cost. Likewise, the dollar costs of a certain regulation may be equal for a community of 5,000 and 50,000. With a fewer employees, customers and citizens over which the regulatory burden can be spread, smaller entities may be severely hindered or even precluded from remaining viable if there is no relief from the disproportionately high regulatory costs.

The Act applies to all federal rules for which the Administrative Procedure Act or any other act requires notice and comment rulemaking. Many rules having particular applicability related to rates, wages, corporate structures and the like, are thus not covered by the Act's analysis requirement. Under the RFA, agencies are required to assess the impact of their proposals on small entities. When the impact of the rule on a substantial number of small entities is significant, the agency must perform a regulatory flexibility analysis. If the impact is not significant or if a substantial number of small entities are not affected, then the head of the agency is permitted to so certify, thereby avoiding the analysis requirement. In other words, the broad analysis requirement attaches only to those rules most significant to small entities.

Agencies must consider analysis at two stages: upon proposal and final publication. When the rule is proposed, an initial regulatory flexibility analysis (IRFA) must be published simultaneously in the Federal Register. The IRFA must include the following:

(a) a description of the reasons why action by the agency is being considered;

(b) a succinct statement of the objectives of, and legal basis for, the proposed rule;

(c) a description of, and when feasible, an estimate of the number of small entities to which the proposed rule will apply;

(d) a description of the reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or records; and

(e) an identification, to the extent practicable, of all relevant federal rules which may duplicate, overlap, or conflict with the proposed rule.

The RFA also requires that each initial regulatory flexibility analysis describe and analyze any significant alternatives to the proposed rule which accomplish the stated objectives of the applicable statute and which minimize any significant economic impact of the proposed rule on small entities. Significant alternatives may include: the establishing of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; the use of performance rather than design standards; or an exemption from coverage of all or part of the rule for small entities. Upon publication of the final rule, the agency must either recertify that the rule will not have a significant economic impact on a substantial number of small entities or prepare a final regulatory flexibility analysis (FRFA). The final and initial analyses differ to the extent that new alternatives are raised during the comment period. If new alternatives are submitted, then the Agency must address those alternatives -- either including them in the final rule or publishing a statement explaining why the alternatives were rejected.

Some agencies have made small entity analysis an integral part of the regulatory process. The Environmental Protection Agency, represented here on the panel with me today, is probably the best example of an agency which has incorporated the RFA into its procedures, and I will discuss in detail some of its efforts in just a few moments. For other agencies, the opposite is true. Many agencies resist performing analyses and instead, focus on ways to exempt their rulemakings from the purview of the Act. Agencies that have not performed well do not have good processes for addressing small business impacts, do not generally perform economic analysis of proposed rules, and do not have an individual at the focal point in the policy decisions network to insure that an agency head's commitment to least burdensome regulation is carried through into practice. The Annual Report which I have submitted to Congress annually since 1981 details these problems. The Internal Revenue Service, the Agricultural Marketing Service at United States Department of Agriculture and the Federal Communications Commission are among the agencies where the benefits of the Regulatory Flexibility Act have not been appreciated and thus not extended to the regulated community. The disparate nature of compliance records of the agencies is in large part due to the lack of enforcement mechanisms contained in the RFA.

## EPA AND THE REGULATORY FLEXIBILITY ACT

As I stated, the Environmental Protection Agency (EPA) is an agency where the implementation of the Regulatory Flexibility

Act has become part of the rulemaking process. Indeed, some of the key concepts of the Regulatory Flexibility Act were derived from the regulatory analysis and approach to small business developed by EPA. The Small Business Administration has had a particularly successful working relationship with EPA, and implementation of the Regulatory Flexibility Act has been enhanced not only by active participation by my office, but also by the participation of other parties in the regulatory development process.

As you know, EPA regulations have a great effect on a broad range of businesses. EPA regulates the generation, storage, disposal and use of hazardous substances which have an existing or potential impact on the environment.

EPA, in balancing the competing interests of the public, government and industry, tries to thoroughly analyze the costs and benefits of regulations. However, despite the extensive analyses performed by EPA, and because of the sometimes conflicting requirements imposed by Congress, EPA regulations are often challenged. In order to either avoid challenges altogether or increase the chances of prevailing in the courts, EPA is careful to compile a complete rulemaking record.

Although EPA's record on RFA compliance is not perfect by any means, I would like to discuss some EPA rulemakings which illustrate the potential effectiveness of the RFA across all agencies of the Federal Government. These examples demonstrate aspects of the goals of the drafters of the RFA--agency commitment to analysis, with participation by the small business sector through the efforts of trade associations, interest groups, individuals and the Office of Advocacy.

Most recently, the Office of Advocacy has worked with EPA to improve regulations under Title III of the 1986 Superfund Amendments and Reauthorization Act (SARA) and the Underground Storage Tanks (UST) rules. First, I would like to discuss the community-right-to-know requirements, which are found in Title III of SARA. Title III imposes several reporting requirements on facilities with hazardous chemicals. During the rulemaking for sections 311 and 312 of Title III, SBA suggested to EPA two ideas to explore in setting permanent reporting thresholds that would meet the statutory requirements while also limiting the effects on small businesses and local governments. As a result, EPA is now performing a more thorough regulatory analysis in order to set an appropriate permanent threshold quantity for reporting chemical inventory data. A higher permanent threshold quantity for reporting would result in less paperwork being generated by small businesses and less to be stored and retrieved by small local governments. Advocacy specifically suggested last year that local governments be surveyed with respect to their experiences and resources under local community right-to-know requirements for input into this rulemaking. EPA is now undertaking that survey. EPA is also conducting an independent study of non-manufacturing thresholds to determine whether it is appropriate to set the non-manufacturing threshold separately from the manufacturing threshold.

EPA also worked closely with the Office of Advocacy to conduct a regulatory flexibility analysis to reduce the costs associated with section 313 of Title III (toxic chemical release reporting). As a result of that analysis, EPA adopted an SBA alternative permitting facilities to estimate small releases of hazardous chemicals in ranges rather than to the nearest pound. Again, the regulatory goal was achieved in a way less costly to small entities. These Title III developments represent a positive application of the principles of the Regulatory Flexibility Act.

In order to maximize the effectiveness of the RFA in the SARA Title III rulemakings, the Office of Advocacy used two important resources: an outside workgroup of interested small business trade associations and a technical contractor.

The outside workgroup was an informal one, modeled after EPA's own rulemaking workgroup. The workgroup reviewed and analyzed the EPA rulemaking materials, and formulated new approaches for analysis and regulation, which were subsequently shared with EPA. This has been a successful technique. For example, the concept of using the Underground Storage Tank form -- which businesses are already required to fill out -- to substitute for reporting of petroleum products under section 311/312 -- which would have required needless repetition of the same information -- evolved through the industry workgroup deliberation.

Advocacy also used a technical contractor to provide additional information for use in the rulemaking process. EPA's decision-making is based on complex information and analyses. By employing a contractor to perform detailed economic and technical analyses of the relevant data, my office was able to participate more fully in the regulatory process, by providing EPA with informed advice and comments. The Advocacy contractor analysis is frequently the only significant small business analysis performed outside of EPA during a rulemaking.

EPA also effectively implemented the Regulatory Flexibility Act in the promulgation of rules as part of the underground storage tank program. EPA was required by the Resource

Conservation and Recovery Act Amendments of 1984 to promulgate certain rules regarding underground storage tanks containing hazardous substances including new tank design and installation, leak detection, financial responsibility and clean-up of spills.

SBA was particularly involved with two major rulemakings in this area, technical standards and financial responsibility. For the technical standards rulemaking, EPA conducted regulatory flexibility analyses, with active small business and Advocacy participation. Through these analyses, EPA determined that a single wall standard provided adequate leak protection at reduced cost. Therefore, EPA is expected to adopt the single wall standard over the more expensive double wall standard in the final rule this month. During this rulemaking, Advocacy again made extensive use of an outside workgroup (also composed of environmentalists) and a technical contractor. The technical standards rule is the result of EPA rulemaking at its best: good input, thorough and thoughtful regulatory analyses (including an extensive small business analysis under the RFA), excellent outreach, and good judgment.

In the area of financial responsibility, both Advocacy and industry groups asked EPA for special treatment of smaller firms: a delay of the effective date of the rule because of the unavailability of insurance. In response, EPA asked for comments on a delay of up to 18 months. EPA is expected to issue the final rule on financial responsibility in October. EPA also determined it would simplify the procedural process followed to obtain a suspension of the enforcement of financial responsibility rules when a class of facilities demonstrates a lack of availability of all financial responsibility mechanisms. There remains, however, one significant problem area regarding financial responsibility. The current unavailability of insurance imposes a very high cost on small local governments who must seek insurance coverage, much like a business, but cannot benefit from class suspension. This rule overlooks the special role of local governments to be responsive to the environmental needs of their communities, with or without such insurance. The cost of seeking insurance reduces the resources available to focus on the technical standards which provide the best environmental protection.

As the above examples illustrate, effective implementation of the Regulatory Flexibility Act is possible when small business and the federal agencies work together. Good rulemaking procedures both protect the interests of small entities and help agencies meet the statutory requirements and objectives of their rulemakings.

In contrast to these successes, I must also briefly mention a few areas where EPA could improve its implementation of the Act. On several occasions, EPA has not been careful to either explain whether a rule is certified as having no significant impact, or to provide a proper explanation for a certification. Certain EPA offices seem to be reluctant to state that a significant impact is expected to occur, apparently to avoid generating adverse comments. Further, in the recent proposal of the "first thirds" land disposal ban, EPA improperly certified a rule without considering the impact on thousands of small business generators of metal hydroxide sludge. After my office objected to this conclusion, the determination was reversed in the publication of the final rule, although the affected industry was not afforded the relief sought in that rulemaking.

I should end this discussion on EPA rulemakings by mentioning a current rulemaking of significant concern under the RFA to both small businesses and local governments. EPA proposed adopting new design and operating requirements for municipal solid waste facilities which could significantly raise land disposal costs for small businesses and local governments. The rule's impact falls most heavily on the smallest landfill owners, particularly local governments.

## SMALL ENTITY ANALYSIS

While many rules have been modified to reflect small business concerns explored in an RFA analysis, agencies have been less likely to consider impacts on other small entities.

Good analyses are based upon good, solid economic data. Reliable data about small businesses upon which policies can be based often exists, but to our knowledge no comparable data has been collected on small governmental jurisdictions. In addition to information collected by the Federal Government such as County Business Patterns, IRS Statistics of Income, or Census Characteristics of Business Owners, the Small Business Administration maintains its own small business data base (SBDB). The SBDB can provide information on employment, sales, industry and geography for more than 4.5 million businesses. Agencies using this kind of information as a basis for analysis are better able to tailor regulations to the specific characteristics of the industries being regulated. In addition, for those trying to persuade an agency to rethink its position, whether it is the Office of Advocacy, a trade association, or an individual small business owner, the data base figures provide a well-documented baseline from which to begin discussion. In other words, small business advocates do not have to speak in generalities; they can offer evidence about the entities they represent. For small governmental units, no such data base exists. Although there are some general statistics about the number and size of government entities, other information which would enable the agencies to better understand the nature of a governmental unit vis-a-vis a certain kind of regulation is unavailable.

Another issue of importance to the functioning of the RFA in relation to small business is the increasing sophistication of the small business organizations and trade associations. These groups are experts on the issues that affect their members and are involved in pertinent rulemakings from inception. They provide a great deal of information to agencies that is useful during the deliberative process. For example, trade associations will survey their members about proposed regulations and report the findings to the agencies during the comment period. Also, they are very helpful in explaining to the agencies the intricacies of their industries and, conversely, will help explain the reasons for agency actions to their members. This relationship, which has developed over time, is the foundation of good agency rulemaking.

## INCREASING THE EFFECTIVENESS OF THE RFA

Although the Act has been quite successful in alerting some agencies to the differences in the abilities of large and small entities to comply with complex regulations, there have been significant gaps in agency support for small entity analysis and the adoption of less burdensome alternatives. The agencies most likely to comply with both the letter and spirit of the RFA are those agencies which, by the nature of their rulemakings, routinely perform regulatory analyses pursuant to other statutes or executive orders. Often their motivation for thorough regulatory analysis is the necessity to build a good rulemaking record that will withstand judicial scrutiny. The RFA itself does not provide an independent basis for judicial review.

As discussed above, an agency is directed under the Act to perform analyses which estimate the economic and administrative impacts of their proposals on small entities. Unfortunately, some agencies resist meeting their obligations under the Act, usually in one of two ways. First, agencies inadequately assess the impact of their proposed rules, or second, agencies improperly certify that their proposed rules will not have a substantial impact on a significant number of small entities. If the Act is to be effective in providing any real regulatory relief to small entities, these two initial decisions should be subject to judicial review.

There has been little judicial review of the implementation of the RFA, but the few cases that do appear have one common thread: the courts feel extremely restricted by the judicial review section of the Act.

The Act indicates that when an agency performs a regulatory flexibility analysis, it becomes part of the rulemaking record and, therefore, may be reviewed if the rule is later challenged in court. In other words, an analysis must be undertaken in order for a court to consider it as a part of judicial review. However, the RFA is clear in stating that RFA analysis is not in itself a basis for review. Problems most often occur when agencies conduct no analysis and improperly certify that their rules will not have a significant impact on a substantial number of small entities.

When an agency certifies a rule, it, in effect, accords itself immunity from review of its RFA compliance. Once a rule is certified as not having a significant impact on a substantial number of small entities, courts will not review that decision or consider RFA compliance when assessing the reasonableness of the rule. In Lehigh Valley Farms v. Block, 640 F. Supp. 1497 (E.D. Pa. 1986), a group of dairy producers asserted that the Secretary of Agriculture's decision to certify a rule failed to comply with the requirements of the RFA. The Secretary determined that changes in certain milk marketing orders would not have a significant impact on a substantial number of small entities, and the plaintiffs contended that the certification of no substantial impact was incorrect. The Court agreed with the plaintiffs. However, the court recognized that the threshold issue was whether the court could review the Secretary's decision to certify. I.d. at 1518. The court reluctantly concluded that RFA certifications were not reviewable, in part because the legislative history on this point was not definitive. Thus by certifying a rule, an agency can avoid having to perform any analysis at all. (In the Lehigh case the court's overall assessment of the agency's rule resulted in rejection of the rule, finding that the lack of a statement of basis and purpose was arbitrary and capricious. Conduct of a Regulatory Flexibility Analysis would have helped the agency avoid this result).

Agencies should not hide behind certification decisions. It is small entities in particular, as well as the economy as whole, that pay the price for uninformed rulemaking. The Regulatory Flexibility Act should be amended to provide for judicial review to ensure that the interests of small entities are in fact being considered. The court in Lehigh Valley went so far as to say that "Congress theoretically rendered Sections 603 and 604 (the sections that require the performance of analyses) nullities based on 605 (the certification section) and 611 (the judicial review section."

Id. at 1520 n. 20. The court then stated: "[i]t is for Congress to correct this anomaly...." Id.

Mr. Chairman, I hope these comments have been informative. Although the Committee's scope of inquiry is broader than the implementation of the Regulatory Flexibility Act, I believe the RFA is useful in examining the way agencies impose regulatory requirements on the public. The analysis results shed light on the way small entities -- both businesses and local governments -- cope with the burdens that Federal law places upon them. The RFA is a limited tool in the administrative process; it could be made considerably better for its small entity beneficiaries.

I'll be happy to answer any questions the Committee may have.

## SENATOR GLENN'S
## QUESTIONS FOR THE RECORD

Mr. Frank A. Swain

1.

In the case of small businesses seeking agency compliance with the Regulatory Flexibility Act, pressure from outside groups -- trade associations, for example -- is essential to ensure success. Local governments, in contrast, have fewer advocacy groups pressing their interests than do small businesses. Does this put them at a disadvantage in their attempts to force agencies to carry out analyses required by the Regulatory Flexibility Act? If so, what can be done to remedy this?

2.

Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to local governments?

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

October 17, 1988

Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Glenn:

I appreciated the opportunity to appear before your Committee on September 14 to discuss the Regulatory Flexibility Act (RFA) and its role in addressing small business and state and local government concerns with Federal agency rulemaking.

Before addressing the topics raised by your questions specifically, I would first like to expand my comments on the reviewability of the Regulatory Flexibility Act. I believe that a general outline of judicial review of the RFA is important in my responses to your specific questions.

The language of the judicial review section of the RFA was controversial when adopted and has led to confused results. The present framework for challenging rules promulgated by the Federal government is provided by the Administrative Procedure Act (APA), which allows for challenging a rule as being arbitrary and capricious. The judicial review section of the Regulatory Flexibility Act, §611, provides limited review of RFA compliance under the Administrative Procedure Act. If a regulation is challenged as arbitrary and capricious under the APA, one factor the reviewing court can consider is the analysis conducted pursuant to the RFA. This type of review was adopted to insure that RFA compliance would not be independently reviewable during the pendency of the rulemaking process, thereby delaying the issuance of regulations. It was also intended to avoid the elevation of form over substance, a result some felt had emerged from the procedure used for reviewing Environmental Impact Statements made pursuant to the National Environmental Policy Act of 1970.

Courts have read the judicial review section strictly. An agency's determination that there is no impact on small entities and refusal to conduct an analysis under Section 603 of the Act has been held to be beyond a court's review. (See The Annual Report of the Chief Counsel for Advocacy on the Implementation of the Regulatory Flexibility Act, October 1988.) Thus, a legislative change to the Act which authorizes review under the

APA of both the adequacy of an analysis and the agency decision to certify could dramatically increase compliance and help ensure that more small entities and the agencies themselves benefit from the consideration and adoption of the least burdensome regulatory alternatives available. This limited change would not establish an independent basis for review of RFA compliance or certification during the rulemaking process.

Topic: Industry Involvement and the Regulatory Flexibility Act

Question: In the case of small businesses seeking agency compliance with the Regulatory Flexibility Act, pressure from outside groups -- trade associations, for example -- is essential to ensure success. Local governments, in contrast, have fewer advocacy groups pressing their interests than do small businesses. Does this put them at a disadvantage in their attempts to force agencies to carry out analyses required by the Regulatory Flexibility Act? If so, what can be done to remedy this?

Response: The active involvement of industry and community groups in rulemaking efforts is an important part of the regulatory process contemplated by the Regulatory Flexibility Act. Much success has been achieved by small business working with certain agencies because of the presence and concern of outside groups who carefully study proposed rules and offer detailed analyses and comments for agency review. Local governments, in contrast, are less aware of the RFA and its usefulness as a tool in rulemaking efforts.

While an organization such as the National Association of Towns and Townships is in a good position to address the extent to which local governments have been disadvantaged by this lack of representation, small governmental jurisdictions do suffer in much the same way small business does if agencies are institutionally insensitive to the impact of their regulations.

One way to increase an agency's institutional attention to small entities is the use of a small entity ombudsman in each agency. The Environmental Protection Agency already has a good small business ombudsman and has indicated that it will pursue establishing another ombudsman for small governments. The key factor for the effectiveness of an ombudsman's office is its placement within an agency. To ensure success the ombudsman must play a role in rulemaking policy and serve as the focal point for input from the regulated community.

Topic: Agency Compliance with the Regulatory Flexibility Act

Question: At the hearing, you were asked to include in your annual report the percentage of proposed rules which fail to comply with the Regulatory Flexibility Act on an agency by agency basis. Will this be available for this year's report?

Response: The Report of the Chief Counsel on the Implementation of the Regulatory Flexibility Act discusses many specific examples of cases where agencies failed to meet obligations under the Act, although an exact percentage of proposed rules for which this is the case is unavailable on an agency-by-agency basis at this time. In 1987, the Office of Advocacy reviewed 1043 proposed rules which were certified and 171 proposed rules to which the Regulatory Flexibility Act was not applicable. Compared to the 1043 that were certified, we reviewed only 112 proposed rules for which an Initial Regulatory Flexibility Analysis had been performed. Thus, impact analysis was undertaken in about 10 percent of the cases. I have instructed my staff to track this information carefully for inclusion in the report for 1988.

Topic: The Impact of State and Local Government Responsibility on Environmental Protection

Question: Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to local governments?

Response: The effect of state and local government involvement in environmental regulation and enforcement is not an issue that has been considered by The Office of Advocacy, nor is it within our direct expertise to do so. Certainly, there are appropriate roles in environmental protection to be played by federal, state and local governments. The impact of state and local government responsibility would be difficult to examine, however, because responsibilities have not simply been transferred from federal control to local control. Instead, the Federal government has imposed new responsibilities for new laws on state and local entities. Often this has happened without the benefit of analysis of the impact on the small entities required to be the implementors of the Federal programs. In other cases, states have adopted new laws where the Federal government has no regulations, again without careful consideration of the burden on small firms that will have to implement the law.

Topic: OMB Review of Regulatory Flexibility Act Oversight

Question: At the hearing there was discussion of the advantages of a more central role for OMB in the implementation and oversight of the Regulatory Flexibility Act. Should OMB have more of a role in the oversight of the Regulatory Flexibility Act? If so, what do you think that role should be?

Response: The Office of Management and Budget exercises regulatory review through Executive Order 12291, which requires agencies to analyze the impact of their proposed regulations when the total impact on the economy exceeds $100 million. Therefore, many rules that affect small businesses and government entities many rules that affect small businesses and government entities already move through an OMB review process. Although OMB is not automatically involved in every rulemaking, I believe that their overview is helpful in ensuring compliance with the law.

It is important that the main responsibility for compliance with the RFA remains with the regulatory agencies. The best means of enforcing this obligation is to create an opportunity for persons injured by agency non-compliance to obtain judicial review.

Again, I appreciate the opportunity to testify. I will be happy to answer any further questions.

Very truly yours,

Frank S. Swain

Frank S. Swain
Chief Counsel

# Senator Carl Levin
# Post-Hearing Questions
# on
# Federalism and the Regulatory Flexibility Act

Questions for Frank Swain, Chief Counsel, Office of Advocacy, SBA

1. At the hearing there was discussion of the advantages of a more central role for OMB in the implementation and oversight of the Regulatory Flexibility Act. Should OMB have more of a role in the oversight of the Regulatory Flexibility Act? If so, what do you think that role should be?

2. At the hearing, you were asked to include in your annual report the percentage of proposed rules which fail to comply with the Regulatory Flexibility Act on an agency by agency basis. Will this be available for this year's report?

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

January 23, 1989

Honorable Carl Levin
United States Senate
Governmental Affairs Committee
Washington, D.C. 20510

Dear Senator Levin:

This letter is written in further response to your question regarding the role of the Office of Management and Budget in the implementation of the Regulatory Flexibility Act.

The Office of Management and Budget (OMB), under the authority of Executive Order No. 12291, reviews draft proposed and final rules before they are announced to the public. The Executive Order requires that agencies perform a Regulatory Impact Analysis if the likely impact on the economy exceeds $100 million. This analysis must accompany the draft rule when it is sent to OMB and must be made available to the public when the rule is issued.

The Executive Order No. 12291 Regulatory Impact Analysis is complimentary to the Regulatory Flexibility Analysis required under the Regulatory Flexibility Act (RFA); in fact, agencies often perform them as one analysis, which is permissible under the RFA. There are differences in the two procedures. First, the obligation of an agency to perform an analysis of small business impact is not triggered by a specific dollar burden, but by the "significant impact on a substantial number of small firms standard (5 USC section 602). If a draft rule will affect only a business sector with relatively few businesses, then the $100 million impact level triggering Executive Order No. 12291 analyses may not be reached, although the impact on small businesses would be significant. Thus an analysis may be required by an agency under the RFA, yet not be required by Executive Order No. 12291.

The second major difference, quite logically, is the focus of the analysis. The RFA analysis not only requires agencies to look at impacts on small entities but also requires them to examine this impact in great depth. The RFA requires that agencies affirmatively try to adopt less burdensome regulations for small entities.

Although the Office of Advocacy, by terms of the RFA, reviews the RFA analyses and regularly comments to agencies on proposed rules, the SBA has no legal authority to stop promulgation of the rule if the requirements of the RFA are not met. Because of the greater authority of OMB, i.e., OMB can stop the paperwork and recordkeeping requirements attendant to a rule under the Paperwork Reduction Act or request changes in the economic analysis under the authority of the Executive Order, OMB's participation in RFA oversight is useful.

OMB has general expertise about regulatory costs and alternatives and SBA has focused expertise about the impacts of rules on small entities. OMB does have a positive effect on the implementation of the RFA when working with the Small Business Administration. Increased focus by OMB on the small business impacts of proposed rules enhances the attention given by Executive agencies to the Regulatory Flexibility Act, possibly resulting in agencies increasing the number of rules for which they perform RFA analyses, and more importantly, improving the quality of those analyses. Even though there are no formal procedures between the SBA's Office of Advocacy and OMB Office of Information and Regulatory Affairs, the offices do regularly work together on an ad hoc basis. I would hope this cooperation between OMB and SBA on rules with a small entity impact would continue and increase.

Finally, I believe that OMB has taken some other steps to reduce paperwork and regulatory burdens on State and local governments, and you may wish to write to them directly for information on these steps.

Please do not hesitate to call upon us if you wish further information.

Very truly yours,

Frank S. Swain

Frank S. Swain
Chief Counsel for Advocacy

cc: Senator John Glenn
Senator William Roth
Jay Plager

STATEMENT OF
RICHARD D. MORGENSTERN
DIRECTOR
OFFICE OF POLICY ANALYSIS
OFFICE OF POLICY, PLANNING, AND EVALUATION
U.S. ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

September 14, 1988

Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to be here today to discuss the way the Environmental Protection Agency has used the Regulatory Flexibility Act to understand and, where possible, reduce the impacts our regulations have on small entities.

## Background

The primary mission of EPA is to protect human health and the environment. In working to accomplish that goal, we strive to avoid undue adverse impacts on the economy in general and on small entities in particular where this does not conflict with the statutory requirements. The Regulatory Flexibility Act (The Act) requires that Federal agencies analyze the effects of new and existing regulations that have a significant economic impact on "small entities." The Act does not amend or repeal other statutory mandates. Therefore compliance with the Act must not compromise adherence to the requirements of other statutes. As defined in the Act, small entities include small businesses, small governmental jurisdictions, and small organizations.

Under this Act new regulations proposed after January 1, 1981 must be accompanied by a Regulatory Flexibility Analysis (RFA) or certification that the regulation, as promulgated, will not have a significant economic impact on a substantial number of small entities. Agencies must also list in the Regulatory Agenda rules being developed which may have such an economic effect.

## Overview of Compliance with the Act

In early 1981, EPA established an Agency workgroup to plan for implementation of the Regulatory Flexibility Act, and to develop a set of internal guidelines. EPA formally issued those guidelines in February 1982. Since that time EPA has concentrated its most careful review of the potential significant economic impacts under Reg Flex on small businesses for each of the 200-250 rulemaking activities underway at any one time that are subject to "notice and comment" provisions of the Administrative Procedure Act. Since March 1981 EPA has proposed 2910 rules and promulgated 3764 regulations. More recently, EPA has increased its attention to small communities as well, by including them in a study of impacts of environmental regulation on several sectors of American society. I will discuss that study a bit later in my testimony.

EPA deliberately considers small business concerns in rulemaking to the extent permitted by statute. Generally, EPA performs detailed analysis to delineate who is affected by a regulation and to what extent. Potentially affected parties are notified via the Regulatory Agenda, Federal Register Notices, and often by other methods such as notices in appropriate trade journals. To the extent permitted by law, EPA encourages affected parties to participate in the development and consideration of alternative means of achieving regulatory objectives. EPA issues rules under fourteen different statutes. The amount of flexibility to address small entity concerns varies from statute to statute.

### The Mechanics of Regulatory Flexibility

Under EPA's guidelines, the process for determining whether to conduct a regulatory flexibility analysis is as follows. First, the Agency must define "small entity" on a case-by-case basis. For this purpose, the Agency may either: 1) use the definitions of "small entity" in the Act, or 2) develop its own definitions by consulting with the SBA and allowing public comment.

Second, the Agency must determine whether the regulation will have a "significant impact" on a "substantial number of small entities." We make this determination on a case-by-case basis. In general, a "substantial number" of small entities is more than 20% of the total number of small entities, but the 20%

rule is a guideline rather than a fixed standard. There may be cases where the intent of the Act indicates the need for a RFA when less than 20% of small entities are affected. For example, some regulations could impose such severe economic hardship on a few businesses that an RFA would be necessary, even though the total number affected might be small. EPA determines what a "significant economic impact" is by considering the differential impact on small entities. The Agency focuses on the costs of production, average profit margin, and compliance costs, cognizant of the fact that small entities frequently have higher average annual costs, lower profit margins, and therefore are less able to contend with the expense of environmental regulations. After reviewing the magnitude of economic impact and the number of entities affected, the Agency may conclude that a RFA is unnecessary. In that case, the Administrator will certify at the time of publication of the proposed or final rule that the rule will not have an adverse impact on a substantial number of small entities. The certification must contain a succinct statement of the reasoning and criteria used to make that determination. Alternatively, the Agency may find the impact to be significant, in which case an RFA must be performed.

## The Regulatory Flexibility Analysis

The Regulatory Flexibility Analysis summarizes the economic impact of a regulation on small entities and discusses alternatives that might minimize the impact and still accomplish the statutory objectives. EPA addresses this by building flexibility into the rule in how small entities meet the environmental standard without weakening the standard. Impacts on small businesses are weighed against risks to health and the environment that would result from reducing requirements on these entities. Consequently, small businesses in different industries may end up being treated differently. For example, based on a Clean Water Act statutory analysis of economic achievability, BAT for certain of the smallest plants in the ferrous subcategory of the metal foundries industry category, which cast primarily malleable iron, was set at a less stringent level. On the other hand, the effluent guidelines formulated for the electroplating industry did not include any exemptions, even though most of this industry is composed of small plants.

The most sophisticated RFAs contain the following elements: explanation of why EPA is considering action, objectives and legal basis of the rule, identification of alternatives, demographic analysis, cost analysis, competitive effects analysis, exemptions or allowances, identification of overlapping regulations and, summary of public comments.

A typical impact analysis was the one performed for the proposed rule for lead and copper in drinking water. We grouped water systems into twelve categories based on the number of people served by each system. EPA determined the cost of the regulation within each category for each household and system, as well as the categorical and total national cost. The analysis showed that the cost of this regulation for small systems would be 3.1 percent of their present water production costs. EPA does not consider this a significant impact. Therefore no special action was warranted.

However, EPA recognizes that due to their inability to benefit from economies of scale, the smallest systems suffer the greatest cost impacts. Therefore EPA included numerous provisions in the proposal which would enhance their ability to implement and comply with the regulation. Among these provisions are:

1. The monitoring requirements of the rule are phased in over an extra two to three years for small systems.
2. Small systems require fewer samples for compliance.
3. Small systems are required to monitor less often than large systems.
4. States may take system size into account when determining appropriate elements of the treatment plan.
5. EPA encourages States to provide technical assistance to small systems which need to install or improve corrosion control.

One of the major goals of the Act is to encourage agencies to "tier" their regulations, that is, to exempt or to set less stringent requirements for small entities. EPA has issued many regulations that have less stringent requirements for small businesses when the Agency's environmental and health objectives would not be compromised. Following are recent examples:

1. Section 311, 312 of Title III, Community-Right-to-Know, requires employers covered by OSHA's hazard communication standard to submit MSDS and facility inventory of chemicals to state and local governments and fire departments. To address the resources required of small entities to comply with this regulation EPA took several steps. We reduced the number of reporting categories from 23 to 5, i.e. the categories for physical and health hazards. We endeavored to design the section 312 reporting form so it would be easy to complete. We also set threshold levels for the first two years that exempt thousands of small businesses from these requirements. These accommodations to the concerns of small businesses were balanced against the intent of Title III to allow broad access to information on the type, amount and location of hazardous chemicals within a community.

EPA works closely with the EPA small business ombudsman and SBA to inform and assist small entities in complying with annual inventory reports. Additionally, in October EPA will distribute a brochure on community-right-to-know and small businesses.

2. Reg Flex analysis determined that the NSPS for New Residential Wood Heaters developed under the Clean Air Act would affect almost all business entities associated with the wood heater industry. Some production costs may increase by as much as 25 percent and some manufacturers, distributors, and retailers may leave the wood heater market as a result of this rule.

EPA incorporated three provisions to soften these effects on small producers. Manufacturers producing fewer than 2,000 heaters a year are granted a one-year grace period to meet the requirements of the regulation. (In effect, this provision also gives them a one-year cost advantage of $100 to $200). Certification testing is waived for a particular heater model if it is similar in all material respects to another heater model that has a certificate of compliance. Additionally small manufacturers are subject to less frequent quality assurance emission tests than large manufacturers. These provisions were made within the framework of the Clean Air Act.

3. EPA conducted extensive analysis of the potential impacts of the Effluent Guidelines for Organic Chemicals and Plastics and Synthetic Fibers Regulation on small businesses. We evaluated all plants with production levels of less than or equal to 5, 10 and 15 million pounds

(annual OCPSF production). We also evaluated production and parent company sales combinations of less than or equal to 5, 10 and 20 million pounds of sales.

Our analysis produced an estimate that 66 small plants would close if full BAT guidelines were followed in regulating the industry. As a result of these findings, EPA mitigated the stringency of BAT guidelines for all direct discharging plants that produce five million pounds or less of product. The provided relief for 19 plants results in savings in annualized cost of $6.4 million and saving 162 jobs. Less stringent standards were not established, however, for the small indirect-discharging plants (that is, plants that discharge into publicly owned treatment works such as municipal treatment systems) because the aggregate amount of pollution discharged by these plants is significantly greater than that discharged by the direct dischargers and disproportionate impacts were not found for these small plants.

4. EPA considers small systems impacts in implementing Safe Drinking Water Regulations in the following manner. EPA is required to promulgate 83 drinking water standards under the 1986 Safe Drinking Water Act. Regulatory requirements for complying with these standards fully consider impacts on small systems in that detection and compliance monitoring requirements are tailored to the scale of operation of PWSs; variances and exemptions from

applying BAT may be granted considering system size; and the schedule that states (as primacy agents) set for bringing different size systems into compliance. In addition the Regulatory Impact Analyses and the Economic Impact Assessments being conducted for each regulation examines the total and incremental costs and benefits associated with regulating specific drinking water contaminants.

5. EPA is concerned about the potential cost to small water systems to comply with the future radon in drinking water regulation. EPA addressed this concern by entering into a cooperative agreement with the University of New Hampshire and the New Hampshire Department of Environmental Services. They determined that simple, low-cost treatment techniques for the removal of radon from drinking water is possible. EPA is continuing to develop low-cost, low technology treatment for small systems in this area.

6. EPA promulgated the "Pesticide Registration; Fees for Processing Activities" rule on May 26, 1988. This rulemaking establishes fees that applicants must pay to EPA when they request certain registration activities under FIFRA. These fees range from $700 for an amendment review to $184,500 for a new chemical registration review. These fees reflect the Agency's costs of conducting these reviews. EPA developed severe economic impact (SEI) waivers

that will waive two-thirds of the fee for each applicant who submits evidence that: their gross annual revenue for all activities does not exceed $40 million, and the fee, or the accumulation of fees in one year or less, exceeds 3 percent of its gross annual pesticide revenue for the company's most recently completed fiscal year. If the company qualifies for the SEI waiver, the fee will be one-third of the amount that exceeds the 3 percent threshold.

EPA established the SEI waiver in an effort ensure that small businesses remain competitive.

## Other EPA Initiatives Independent of the Reg Flex Act

In addition to an aggressive implementation of the Regulatory Flexibility Act to address small entity issues, EPA has initiated other independent actions to analyze and facilitate small entity compliance with these and future environmental regulations.

### EPA Small Business Ombudsman

One of the first actions EPA took along these lines was to establish the position of Small Business Ombudsman (SBO). The Ombudsman is in the Office of Small and Disadvantaged Business Utilization, which is located in the Office of the Administrator. The Ombudsman's primary function is to aid the small business community in its efforts to comply with environmental regulations. Toward this end, the Ombudsman has sought to meld a cooperative working relationship with both the regulated community and key offices throughout the Agency.

Since its creation in 1983, the SBO has handled more than 45,000 telephone hotline and mail requests for advice, information, and assistance on compliance with EPA regulations. It has mailed hundreds of thousands of brochures and pamphlets to small businesses in search of information. SBO staff have personally spoken to thousands of small business people in appearances before trade associations and organizations across the nation.

In conjunction with the creation of the SBO, EPA has set up Small Business Liaisons in each program office and region to facilitate and foster communication with the Ombudsman. More recently, the Ombudsman has been incorporated into the Office of Advocacy.

### The Small Communities Ombudsman

Presently EPA is trying to establish a full time focal point for small communities, a small community ombudsman. This ombudsman would serve as a focal point for small community concerns by representing their interests within the Agency as well as working directly with small government representatives. This would include insuring that as we go forward developing regulations that we look at flexibility for small communities, financially and technically, without weakening the environmental standard.

## The Sector Study

In the Fall of 1987, the Administrator requested OPPE and the Program Offices to conduct an analysis of the costs and risks of environmental controls across different sectors of the economy, primarily concentrating on the municipal, small business and agricultural sectors. The Administrator's request arose from the concern that EPA's regulation review process only focuses on one regulation at a time. When examined individually, the impact of each regulation may be small, but the cumulative impacts may impose greater financial burdens.

The Sector Study examined the costs for 85 recent and pending EPA regulations and, for many, estimated their impacts upon three sectors: Agriculture, Small Businesses, and Municipalities.

EPA initiated the study in order to provide a critical self-examination of how we, as an Agency, collectively affect certain sectors of the national economy. The information is just one of the factors which can guide future Agency decisions, and will help us in our job of informing Congress and the public about regulatory impacts. Accordingly, we explored whether our current method of looking at actions one at a time misleads us about cumulative impacts. We also wanted to see if cumulative effects appeared particularly large for any one of the three sectors.

Assuming a realistic set of future actions, the following situations may evolve for municipalities, businesses and agriculture.

## For Municipalities

A significant proportion of small communities (under 2,500 persons) may be required to raise user fees to finance new capital requirements and expand monitoring, operation and maintenance practices to levels that exceed what most communities have traditionally paid for environmental services. The increases in fees will be accompanied by a greater reliance on local debt financing mechanisms to provide funds to purchase capital equipment. Although many of the smaller communities are unaccustomed or eschew using debt financing mechanisms, their current financial conditions do not preclude most from using these mechanisms to obtain capital necessary to meet the requirements.

The largest costs-per-household to meet the environmental requirements tend to fall on the smallest and largest communities (under 2,500 and over 250,000 respectively). Smaller communities have not invested as heavily in some environmental services and technologies. Yet they must meet the same technological standards, several of which are now in-place in larger communities. The costs of these technologies decline on a per-household basis as the number of households increases. Therefore, smaller communities will pay more per-household for comparable services to meet the requirements than will larger communities. The large potential increases to the largest communities is primarily due to additional investments in wastewater treatment and solid waste disposal.

The communities that may have the greatest difficulties financing the additional requirements are the smallest ones. Either their existing financial obligations, or the amount of additional capital they must raise to support improvements in environmental services will require that many small communities allocate large portions of their current revenue to cover their debt obligations. This result contrasts with the impacts on larger communities. Of those larger communities that may have difficulties financing environmental improvements, most will have trouble as a result of their large current financial obligations. The additional requirements should not create difficulties where they do not already exist.

Several regulations that may affect municipal governments were not included in the analysis, so the extent of impacts may be underestimated. On the other hand, the time period over which the requirements will be instituted may be long enough to allow for gradual adjustments to user fees and city finances, so the severity of impacts my be reduced. Other mitigating measures, such as privatization or merger, may also reduced the severity of the impact.

## For Small Business

The vast majority of small businesses are in industries that have few environmental problems. These small businesses are not normally affected directly by environmental regulations. A review of nine industries suggests environmental costs may be high for small businesses in three of these industries and in segments of five others.

Small businesses with significant environmental problems, such as leaking underground storage tanks or hazardous waste contamination, will face the greatest environmental expenditures. Several environmental regulations will be imposed on small businesses in nine industries. These industries are dry cleaning, electroplating, farm supply stores, gasoline service stations, interstate trucking, pesticide formulating and packaging, photofinishing laboratories, water supply and wood preserving.

## For Agriculture

Impacts for major field crops vary greatly from producer to producer depending on the crop grown, financial strength of the operation, and geographic location. None of the farmers in average financial condition were predicted to go out of business due to projected EPA actions, even when they were assumed to be affected by all possible actions.

For specialty crops, we did not have any information on their initial financial condition, and thus were unable to predict whether they would go out of business; however, it is clear that predicted impacts may be significant for some growers in some regions, e.g., Florida tomato growers, and apple producers in New York and Michigan.

Conclusion

A major benefit of the Regulatory Flexibility Act is that it has significantly increased the Agency's awareness of and responsiveness to the impacts of its regulations on small entities. In recent years, we have seen legislation such as the Hazardous and Solid Waste Act Amendments that limits the exemptions that the Agency can grant for small firms. Although the Agency must give primary consideration to reducing risk to health and the environment, we do pay attention to the special burdens small entities bear in adapting to regulatory requirements. Increasingly, education and technical assistance, as well as other efforts to support compliance, have become important ways of achieving the objectives of the Regulatory Flexibility Act.

Mr. Chairman, this concludes my prepared statement. Thank you again for the opportunity to be here today. I would be happy to attempt to respond to any questions you may have, either now or later in writing.

## RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR GLENN

QUESTION: Secretary Lash testified that EPA has been slow in promulgating standards in important areas such as toxic air pollution. Can you please respond to that charge?

ANSWER: The Agency has in place a multi-dimensional, targeted control program for air toxics. We have spent a lot of time and energy over the past several years improving our air toxics control program under section 112 of the Clean Air Act. Up to this point, we have listed eight pollutants under section 112, and we have established national emissions standards for seven of them. We have published our intent to list 10 more pollutants, and national emissions standards for those 10 will begin to be proposed in 1989. At the same time, we are working with State governments to develop control programs for those hazardous air pollutants and sources that are not a national problem, but that may pose a health threat in specific areas.

The EPA's air toxics regulatory program is not limited to our efforts under section 112 of the Clean Air Act. We are managing a broad-based program using a number of provisions of the Clean Air Act, and other environmental legislation as well. For example, EPA has recently promulgated rules under section 111 of the Clean Air Act for woodstove emissions and has activities underway to control municipal waste combustor emissions and municipal landfills under section 111 as well. We are considering standards to control chromium emissions from air-conditioning cooling towers under section 6 of the Toxic Substances Control Act (TSCA). We are acting to control toxic air emissions from hazardous waste treatment, storage, and disposal facilities under the Resource Conservation and Recovery Act (RCRA). Existing mobile source controls are reducing several different toxic air pollutants; in addition, under Title II of the current Clean Air Act, we have proposed to ban lead entirely from gasoline, and to further control particles from diesel engines. Any particulate or volatile organic compounds (VOC) controls now or soon to be in place under existing authorities have the added benefit of reducing emissions of toxic air pollutants, as would any further VOC controls mandated in the proposed Clean Air Act bills.

A major factor which has slowed recent progress in EPA's regulatory program in toxic air pollutants is the decision by the District of Columbia Circuit Court in the "vinyl chloride" case (824 F.2d 1146). As a result of this decision, EPA was forced to reevaluate the way in which standards are to be set under section 112. The results of our internal deliberations on this question were published this past July in the proposal (53 FR 28496) of benzene standards remanded to the Agency after the vinyl chloride decision was handed down. Regulations scheduled for proposal under section 112 have been delayed pending a regulatory decision on the final benzene rule.

QUESTION: In the context of small governments -- not small businesses -- what are the major barriers to compliance with the Regulatory Flexibility Act within the EPA?

ANSWER: EPA has a strong record of compliance with the Regulatory Flexibility Act, and we will continue and strengthen our efforts in this area in the future. As the Administrator has proposed a focal point for municipalities is being established at EPA.

QUESTION: At the hearing, we heard some examples of individual rules which were made better by the completion of a regulatory flexibility analysis under the Regulatory Flexibility Act, However, the witnesses representing local governments testified that much of their problem is the burden of a whole range of federal and state regulations. How does the EPA assess the aggregate impact of its regulations? Does the Regulatory Flexibility Act require any sort of assessment of the total regulatory burden on small entities?

ANSWER: As called for by the Regulatory Flexibility Act, EPA only assesses the impact of individual regulations on small entities. However, EPA Administrator Lee Thomas recognized the limitation of such an approach and last fall asked for an assessment of the cumulative impact of EPA's regulations on small entities. In my testimony, I described the results of the Sector Study, which examined the cumulative impact of regulations on municipalities, small business and agriculture.

QUESTION: In the case of small businesses seeking agency compliance with the Regulatory Flexibility Act, pressure from outside groups -- trade associations, for example -- is essential to ensure success. Local governments, in contrast, have fewer advocacy groups pressing their interests than do small businesses. Does this put them at a disadvantage in their attempts to force agencies to carry out analyses required by the Regulatory Flexibility Act? If so, what can be done to remedy this?

ANSWER: The Administrator has proposed to establish a focal point for municipalities at EPA and planning is underway to carry this out in the near term.

Question:

Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to local governments?

Answer:

Environmental clean-up and protection has always been accomplished through the delegated and decentralized efforts of Federal and local governments. Congress sets the priorities and establishes the goals through statutes; EPA sets standards and regulations designed to implement the statutes. The Agency then monitors Federal and state efforts to administer these standards and regulations.

In the past several years, the responsibilities of local governments have been increasing. Unfortunately, we don't have data that would allow us to provide a quantitative answer regarding any changes in the quality of the clean-up and protection efforts over time. We believe, however, that local governments are frequently in a better position to understand the needs of their community and what remedies are most effective in meeting them. In these situations, the Agency's role is to provide technical support on clean-up methods and guidance on how to evaluate the risks associated with various levels of clean-up. With EPA providing its support, we believe that clean-up and protection, in these situations, can be managed best at local levels, where local problems are known and solutions can be made most effective and least burdensome.

RESPONSE TO A WRITTEN QUESTION SUBMITTED BY SENATOR LEVIN

Question:

In your regulatory agenda from April of this year, a number of rules list the effect on small entities as "undetermined." How does this term comply with Section 602, part 2, of the Regulatory Flexibility Act? What steps does EPA take with regard to the Regulatory Flexibility Act for an "undetermined" rule? Is the rule analyzed as to its effect on small entities at some later point? If so, how does EPA proceed with a rule that remains "undetermined"?

Answer:

The use of the term "undetermined" in the Regulatory Agenda describes the status of EPA's analysis more precisely than the Regulatory Flexibility Act (the Act) actually requires. The Act requires EPA only to indicate rules likely to have a significant economic impact on a substantial number of small entities. EPA states "yes" or "no" when it has made a definite determination that the particular regulation will or will not significantly impact small entities. When the regulatory options are not well enough developed, or the available data are insufficient, to allow EPA to make a reasonable determination as to whether or not the regulation will affect a significant number of small entities, EPA lists this as "undetermined". EPA believes the use of these three classifications; "yes", "no" or "undetermined", more accurately describes the status of EPA's analysis. Furthermore, we believe the use of "undetermined" is more useful to small entities than a speculative "yes" or "no" that connotes more certainty than may be warranted.

When the classification "undetermined" is used in the Regulatory Agenda, EPA continues to refine the regulatory alternatives and/or to obtain the data necessary to determine how many, and to what extent, small entities are affected by the regulation until a definite conclusion is reached. EPA always states these conclusions in the preamble of proposed and promulgated regulations.

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR SASSER

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QUESTION: What type of data base does the EPA have for estimating the cost of its regulatory proposals to small governments?

ANSWER: The EPA does not make use of a single data base, but use several data bases, each one having a particular usefulness for the regulations being developed. The Office of Drinking Water uses a data base developed using a survey to describe what communities pay for drinking water services. The costs of new regulatory proposals are based upon engineering cost estimates that account for required technological improvements. The Office of Solid Waste also uses information from surveys of Solid Waste handling and disposal facilities. They supplement this information with data collected by the U.S. Bureau of the Census on city and county governments. The Census data provides information on annual small cities budgets for solid waste, drinking water and wastewater treatment. Other EPA program offices make use of this data, as well as collect additional data on expenditures for proposed regulations.

QUESTION 1-A: Do all departments have access to this data?

ANSWER: Yes, all EPA programs can make use of this data, and there are continual dialogues on how EPA can make better use of this information.

QUESTION 1-B: (No response necessary)

QUESTION: Do you believe that it is possible for the average small government (less than 5,000 people) to comply with EPA regulations, given their limited resources?

ANSWER: Yes, we expect that most small governments will have sufficient financial resources, and their residents will have sufficient income to pay for the regulations examined in our cumulative cost analysis. However, there may be some small communities that will have to make sufficiently large investments to overextend their economic resources. Our analysis indicates that communities that have fewer than 2,500 persons have the greatest potential difficulties. Of the approximately 26,000 communities of this size, 20% to 30% may have some initial difficulties meeting the proposed regulatory requirements.

QUESTION: I understand that a cumulative cost analysis has been prepared which looks at the total burden or approximate burden of EPA regulations on small communities. Would you provide a copy of that to the Committee?

ANSWER: Yes, we will forward a copy of the report to you. It is titled "The Municipal Sector Study: Impacts of Environmental Regulation on Municipalities". It should be available by the end of October.

QUESTION 3-A: What is the projected cost burden of small governments for proposal clean water regulations, wastewater treatments regulations, and drinking water regulations.

ANSWER: The cost analysis prepared EPA on municipal governments provides cost estimates for several regulations. We have attached two tables included in the study to illustrate several cost estimates. Table 1 indicates the potential average capital and operating costs for a set of proposed regulations in drinking water, wastewater treatment, solid waste, and miscellaneous (i.e., underground storage tanks, Asbestos-in-schools, SARA Title III). For example, for cities under 500 persons, total average additional drinking water capital costs are estimated to be $40,000 and annual operating costs are $4,000. Table 2 recalculates these costs, and presents them in terms of the average annual cost per household. For example, the average household in cities under 2,500 persons, will pay an additional $170 per year (by 1996) for all services. This is broken down to the same four categories described in Table 1.

## Table I

## POTENTIAL WEIGHTED AVERAGE CAPITAL AND O&M COSTS FOR ADDITIONAL EPA REGULATIONS

(Thousands of 1986 dollars)

| | Type of Cost | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Drinking Water | | Wastewater | | Solid Waste | | Miscellaneous | | Cumulative | |
| Municipality Size Category | Total Capital Cost | Annual O & M Cost | Total Capital Cost | Annual O & M Cost | Total Capital Cost | Annual O & M Cost | Total Capital Cost | Annual O & M Cost | Total Capital Cost | Annual O & M Cost |
| 0 - 500 | 40 | 4 | 23 | 2 | 2 | 2 | 37 | 5 | 102 | 13 |
| 500 - 2,500 | 46 | 7 | 115 | 5 | 10 | 10 | 43 | 6 | 212 | 28 |
| 2,500 - 10,000 | 105 | 14 | 264 | 11 | 37 | 37 | 114 | 11 | 519 | 73 |
| 10,000 - 50,000 | 274 | 39 | 1,058 | 44 | 172 | 171 | 390 | 35 | 1,894 | 289 |
| 50,000 - 100,000 | 1,132 | 110 | 3,285 | 132 | 591 | 435 | 770 | 72 | 5,778 | 750 |
| 100,000 - 250,000 | 1,869 | 203 | 9,510 | 365 | 2,350 | 968 | 1,889 | 233 | 15,618 | 1,769 |
| 250,000 - 500,000 | 6,421 | 661 | 30,354 | 1,291 | 11,875 | 2,699 | 3,999 | 612 | 52,649 | 5,264 |
| Over 500,000 | 10,010 | 1,457 | 102,742 | 4,041 | 26,597 | 6,835 | 9,632 | 1,066 | 148,980 | 13,399 |

* Many of the cost estimates are based on existing regulatory development documents and are subject to change. For more information see Appendix B.

Source: EPA Cost Estimates

## TABLE 2

## POTENTIAL INCREASE IN ANNUAL USER CHARGE DUE TO ENVIRONMENTAL REGULATIONS

(Dollars Per Household)

| Municipality Size Category | Number of Municipalities | Types of Regulations | | | | |
|---|---|---|---|---|---|---|
| | | Wastewater | Drinking Water | Solid Waste | Miscellaneous | Cumulative |
| 0 - 2,500 | 26,315 | $ 45[*] | $ 40 | $ 26 | $ 59 | $ 170 |
| 2,500 - 10,000 | 6,279 | 20 | 15 | 23 | 32 | 90 |
| 10,000 - 50,000 | 2,694 | 20 | 5 | 32 | 23 | 80 |
| 50,000 - 250,000 | 463 | 20 | 10 | 28 | 12 | 70 |
| Over 250,000 | 59 | 60 | 15 | 51 | 34 | 160 |

[*] User charge increases have been calculated using weighted average costs of new regulations. The costs that a municipality may incur will depend on the regulations it has to comply with.

## RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR HEINZ

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Question: The Congressional Budget Office testified that the states are assuming much of the technical and funding responsibilities for the so-called "new" environmental problems, which include: global warming, ground-level ozone, indoor air pollution, and groundwater contamination. With so may of these problems being not only national but international in scope, a mere agency probably does not have the resources or authority to move other nations, to bring regulatory problems directly to the Cabinet and to the President, and to protect itself against other Cabinet-level departments. Given the tremendous scope and potential impact of regulations that will arise from these problems, wouldn't the states and localities, not mention the nation as a whole, be better served by making EPA a Cabinet-level department?

Answer: As Administrator Lee Thomas has stated publicly, the nation would be best served by making EPA a cabinet-level department.

Question: Do you agree with CBO's assessment that any new policy development in those areas -- of global warming, ground-level ozone, and the like -- will fall primarily upon the states and not upon the federal government, and, if so, doesn't that trouble you, given that these are really national, and international, problems?

Answer: There is a role for both the Federal and State governments in all these new areas. In each case the relative responsibilities and burdens are likely to be different, depending on the characteristics of the environmental problem being addressed. Where there is significant scientific research to be done and where international cooperation needs to be achieved, the Federal government will have to play a major role. Global warming is an example. On issues where impacts are better understood, where a framework of national policy exists, where the causes are more local and where flexibility in local implementation is needed, a relatively larger state (and local) role is most appropriate. Many issues concerning implementation of ground-level ozone and groundwater protection programs fall into this category.

**Question: Secondly, while EPA may have sufficient wherewithal at present, I would think, and don't you agree, that the magnitude of forthcoming environmental problems -- such as global warming -- is going to require a greatly enhanced EPA, namely a Cabinet - level department?**

**Answer: As I mentioned in my answer to Question 1, Administrator Lee Thomas has stated publicly that the nation would be best served by making EPA a cabinet-level department.**

Question: Your testimony before the Committee indicated that the smallest communities, those of 2,500 residents or less, will face the greatest difficulty meeting environmental mandates -- they will have to increase user fees, use debt financing mechanisms, and so forth. Given this reality, what would EPA's position be on legislation such as Senator Durenberger's, S. 585, which would require reimbursement of direct costs of new Federal mandates, and, if you do not favor such an approach, how are we to compensate those governments for these costs? Should we bring back revenue-sharing or will we simply render new regulations unenforceable because State and local governments do not have the funds to implement them?

Answer: While we anticipate that some of the communities in the 2,500 and under category may experience some initial difficulties in meeting proposed regulatory requirements, we expect that the majority (and most of those in the 2,500 to 5,000 range) will have sufficient resources available. The Agency has not taken a position on any proposed legislation implementing the suggestions you mention.

## Statement of
## Elliot Schwartz
## Acting Assistant Director
## for
## Natural Resources and Commerce Division
## Congressional Budget Office

Mr. Chairman, I am pleased to appear before this Committee to report on work in progress by the Congressional Budget Office on environmental federalism. Programs to protect the environment are increasingly shared by federal, state, and local governments. At every governmental level, constraints exist on the resources that can be devoted to both existing and emerging problems. My testimony today highlights some of the trends in environmental federalism and reviews some specific criteria that may help guide the Congress in making decisions concerning the role of governments in environmental protection. My remarks summarize a staff working paper prepared at your request and released today, entitled: "Environmental Federalism: Allocating Responsibilities for Environmental Protection."

### TRENDS IN ENVIRONMENTAL FEDERALISM

The relationship between federal, state, and local governments in the field of environmental protection has changed profoundly over the last 30 years. From being primarily a state concern in the 1950s and 1960s, environmental protection became increasingly a federal concern during the 1970s. Since the 1970s, however, the role of governments has changed again, notably in the major air, water, and hazardous waste programs, in which a growing portion of both program and funding responsibility has been taken on by the states. The same is true for many emerging or new environmental programs such as indoor air pollution and groundwater contamination. By design or default, much of the new regulatory activity in these areas is coming from the states.

## Program Responsibility

Most states now run their own air program under the Clean Air Act; 39 states run permit programs as required by the Clean Water Act; and more than 40 states administer all or part of the hazardous waste programs under the Resource Conservation and Recovery Act. The role of the federal government has shifted to maintaining a strong role in enforcement, to overseeing and approving state plans, and to providing technical guidance and funds for research.

In the newer environmental programs, states are responsible for initiating many of the regulatory initiatives for control of toxic pollutants in the air, both outside and inside homes; for protecting groundwater quality and quantity; and for limiting nonpoint-source pollution of surface waters.

## Funding Responsibility

This evolution of program responsibility is reflected in the funding for environmental programs. While total environmental program budgets for federal and state governments combined have increased in recent years, the mix of federal and state funds has changed. Compared to ten years ago, EPA's operating budget for the major air, water, and hazardous and solid waste programs has declined in real terms from a peak of $1.1 billion to around $800 million (in 1987 dollars). Federal grants to states have also decreased by almost half, from almost $500 million in 1979 to around $250 million in 1987. Meanwhile, estimated state expenditures in these areas, excluding money from federal grants, rose from around $200 million in 1982 to over $400 million in 1986. Thus, states are funding a growing portion of the nation's environmental programs. In 1982, EPA program grants to states covered approximately half of total state expenditures on air and water quality and three-quarters of state hazardous and solid waste management costs. By 1986, the federal portion had dropped slightly for air quality and had declined to one-third for water quality programs and to 40 percent for waste management.

These changes in program and funding responsibility have not come without costs. Many states and municipalities complain that they are overburdened by their new responsibilities and are or will be unable to raise the necessary revenues to continue to manage and enforce existing programs and develop new ones. In addition, the nature of the emerging federal/state and local partnership provides greater opportunity for tension between levels of government as states seek greater autonomy from federal requirements in line with their increased responsibility for paying the way.

## ALLOCATING PROGRAM AND FUNDING RESPONSIBILITY

The roles for federal, state, and local governments in environmental protection have not yet been fully defined. Governmental roles in the more mature air and water programs continue to evolve. Newer environmental programs present an even cleaner slate for defining governmental roles. The ultimate assignment of responsibility for environmental protection among different levels of government will determine, in large part, the types of programs that are developed, the effectiveness of these programs, and the level of environmental quality achieved.

Federal, state, and local governments are not equally capable of handling all the different activities--for example, standard setting, program design, enforcement, and funding--that are associated with environmental protection.

To assist the Congress in determining what is the most appropriate division of effort among the different levels of government, our working paper reviews a set of broad economic guidelines. These guidelines argue for a division that promotes levels of protection and types of programs that are efficient and also equitable. By efficiency we mean that a program should balance benefits and costs, that benefits should be achieved at the lowest cost possible, and that benefits should accrue to the people and groups who place the most value on them. By equity we mean a fair distribution of benefits and costs. For example, equity may imply that the costs of environmental programs should be borne by those with responsibility for the problems to the extent that they are able to do so. Equity also implies that the benefits of environmental programs should be evenly distributed among different groups.

In general, the level of government best suited to running environmental programs is the level that is best able to assess costs and benefits accurately and to act on that assessment to produce environmental programs that are efficient and equitable. Levels of government typically vary in their abilities to do this.

Smaller units of government tend to be closer to the environmental problem and to the persons and firms affected.

As such, they may have better information on local circumstances and thus be able to assess costs and benefits more accurately. If so, they may be able to provide programs that better address specific local problems and circumstances. Smaller units of government may also have an advantage in terms of flexibility and the ability to provide more innovative solutions to environmental problems. These same characteristics may also enable lower levels of government to be more responsive to equity concerns.

Larger units of government on the other hand, may be able to provide more efficient and equitable environmental protection under certain circumstances. If a substantial number of people and firms receiving benefits or incurring costs under a program are located outside the boundary of a jurisdiction, it is less likely that the local government will take into account the preferences of these groups and accurately assess the level and distribution of the costs and benefits. In addition, some activities (such as setting health or technology-based standards) require substantial amounts of technical information. Small governmental units may not be willing to incur the costs of developing or acquiring this information. Finally, a program may have economies of scale in administration or construction, as in issuing permits or building wastewater treatment plants. If so, then larger government units may be better able to capture these economies and provide lower-cost services.

The degree to which these guidelines will give preference to one level of government over another depends on the specific program activity and environmental problem. Consider, for example, the task of setting standards. Variations in local standards allow flexibility in responding to unique regional circumstances, and allow the adoption of environmental quality levels that reflect local benefits and costs. On the other hand, uniform national standards provide a minimum standard of health for everyone, and thus may be justifiable on other than efficiency grounds.

As another example, it is often assumed that the governmental unit responsible for daily implementation of a program is in the best position to develop the most appropriate methods for funding it. This may not always be equitable and efficient. The costs of program management and compliance imposed by federal regulations may be substantial at the state and local levels. The burden of complying with these regulations may also be unevenly or unfairly distributed among jurisdictions; if so, then additional federal support may be justified on the basis of equity and as a mechanism for persuading state and local governments to comply with national regulations.

These guidelines will only be useful if they can be applied in a practical way to specific problems. In the next phase of our analysis, we will apply the efficiency and equity guidelines to a set of current environmental problems. We will be particularly interested, among other things, in the information requirements underlying many of the criteria and the ability of current monitoring and testing resources to provide that information.

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR GLENN

Question 1:

The Committee heard from several witnesses that local governments could very soon reach a point where their regulatory burden is so great, they are forced actually to ignore federal law. Doesn't this problem--the problem of an absolute limit to the amount of responsibility local governments can bear--undermine any system of "ideal federalism" such as the one your paper lays out?

Answer 1:

Federal statutes and regulations may be burdensome to state and local governments both because of the types of requirements that are imposed and because of the number of requirements. Crucial to both types of burden, however, is the ability of governments to fund the necessary programs and compliance activities.1/ Several factors, including income constraints and political will, can limit the fiscal capacities of federal, state and local governments and, in turn, their ability to comply with federal requirements. At some point, federal mandates may outstrip the capacities of state and local governments to fund required programs and activities while maintaining desired levels of other state and local public goods and services. This general problem may be exacerbated by recent tax-limiting referenda, such as California's Proposition 13, as well as other impediments to raising revenue, including those potentially resulting from interjurisdictional competition. Allocating responsibility to lower levels of government without giving attention to the financial abilities of these levels of government to carry out assigned functions, and without providing necessary funding can result in poorly executed programs and responsibilities.

Realistically, the issue of burden should be discussed in terms of relative limits to spending--the amount that a jurisdiction is willing to spend on environmental protection relative to other public and private sector spending. Does the existence of relative limits on government spending alter the federalism paradigm? To the extent that these limits are unknown to federal legislators and regulatory agencies, the answer is "yes." Unfortunately, there is no single "perfect" measure of fiscal capacity--that is, of the ability of a government to raise necessary revenues. The limit to government spending depends not only on the levels of income in the jurisdiction, but also on the preferences of the population for environmental spending relative to other types of public and private sector expenditures. If national priorities differ from state and local priorities, then federal delegation of responsibilities may, indeed, constitute a burden on lower levels of government.

On the other hand, as discussed in the "Environmental Federalism" working paper, funding is one of the functions that must be assigned to some level of

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1. The "Environmental Federalism" working paper presents several economic criteria that can be used to evaluate allocating program and fiscal responsibilities across levels of government. Different levels of government may be better suited to undertake different environmental protection activities as a result, for example, of information requirements, the size of the jurisdiction, or the nature of the problem.

government. As such, the decision of which government should fund a program can be made subsequent to assigning program responsibility. Following the same principles that guide other allocation decisions, responsibility should be allocated in order to promote decisions that result in environmental programs and levels of protection that are efficient and equitable. Thus, within the framework of federalism, federal funding to supplement state and locally generated revenues may be warranted to ensure that governments possess adequate resources to implement efficient and equitable programs, that national goals are met, and that the burdens are distributed equitably. On a case by case basis, the need for funding may differ among individual states and localities with disparate income levels and pollution problems.

Question 2:

Has actual environmental clean-up and protection benefited or been harmed by the transfer of responsibilities to state and local government?

Answer 2:

In a recent report, Environmental Progress and Challenges: EPA's Update, the U.S. Environmental Protection Agency describes strides in environmental improvement that have occurred since the 1960s, including reductions in atmospheric lead and carbon monoxide concentrations, improvements in sewage treatment, and the restoration and protection of many rivers, streams, and lakes for fishing and swimming activities. While improvements in environmental quality have occurred, it is difficult to determine the extent to which the major environmental statutes have contributed to this cleanup, and whether these improvements have been enhanced or delayed by the allocation of program responsibility embodied in the statutes.

The data presented in the federalism paper describe the growth in statutory and other responsibilities during the past decade, as well as the net decline (in real terms) in the operating budget of the U.S. Environmental Protection Agency during the same time period. These trends could suggest that there is increasing risk that the major programs may be inhibited or may not get the scrutiny that they should at both the federal and lower levels of government. Alternatively, the decline in federal funds is less problematic if governments are becoming more efficient, or if problems faced in the early years of program development have now been solved.

The types of environmental problems being addressed are changing and all levels of government are facing budget pressures. These developments imply that the partnerships and approaches that have worked in the past may not continue to work in the future, and that different divisions of responsibility may be necessary to deal with these problems effectively. For example, the emphasis in environmental protection appears to be shifting from dealing with national environmental problems, such as the "criteria air pollutants," to problems with transnational implications, such as acid rain and global warming, and to more localized or regional concerns, such as radon, groundwater contamination, and household waste disposal. At the same time, many of the easier decisions to control national pollution problems have been made. As a result, the more mature protection programs may be at turning points. For example, the increasing costs of controlling air pollutants, such as ozone, require difficult choices for both federal and state or local officials and test the existing relationships between these governments.

# TESTIMONY OF JOAN CLAYBROOK, PRESIDENT, PUBLIC CITIZEN BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS ON THE IMPACT OF EXECUTIVE ORDER 12498 ON THE REGULATORY PROCESS

October 3, 1988

Mr. Chairman; Members of the Committee: My name is Joan Claybrook, and I am President of Public Citizen, a non-profit consumer advocacy organization founded by Ralph Nader, which has over 50,000 members nationwide. Appearing with me today is David C. Vladeck, a senior attorney at Public Citizen Litigation Group, who has litigated a number of cases involving the Office of Management and Budget's interference with the rulemaking process.

Thank you for the invitation to appear before you today to comment on the impact of Executive Order 12498 on the regulatory process. As the Committee is no doubt aware, this Administration has centralized control of the administrative process in the Office of Management and Budget ("OMB") to an unprecedented degree. Executive Order 12498 completes the shift in the locus of regulatory decision making begun by Executive Order 12291 from the regulatory agencies to OMB. Under these two Executive Orders and the Paperwork Reduction Act, OMB now exercises extensive control over the administrative process from start to finish. With this power, OMB has managed to repeatedly cut back on health and safety regulations, both by weakening regulations and delaying their issuance.

Executive Order 12498 plays a key role in giving OMB this control over the administrative process. Taken alone, Executive Order 12498 accords OMB the power to shape the agenda of all

Executive Branch agencies, since it directs OMB to review on an annual basis each agency's regulatory policies, goals, and objectives for the coming year and information concerning all significant regulatory actions underway or planned. OMB may return part or all of a proposed regulatory program that it views as inconsistent with the Administration's policies and priorities or out of line with the requirements of section 2 of Executive Order 12291, namely, that administrative decisions must be based on "adequate information concerning the need for and consequences of proposed government action" and that agency priorities "will maximize the aggregate net potential benefits to society when the societal costs and benefits are compared." With its control over an agency's budget, including an agency's resources for research, data gathering, surveys, and other types of information development, there is little likelihood that agencies will fight with OMB on any particular regulatory initiative.

But Executive Order 12498 cannot be examined in isolation. While it focuses on the development of an agency's priorities, Executive Order 12291 and the Paperwork Reduction Act give OMB enormous control over the agency's final work product. Under Executive Order 12291, all executive branch agencies must send proposed and final regulations to OMB for pre-publication review. OMB can prevent an agency from publishing a final rule until OMB has given the agency its comments and the agency has responded to OMB's satisfaction. Since the Executive Order neither imposes enforceable time limits for the completion of OMB review nor limits the number of times OMB can disapprove the agency's action, the Order gives OMB de facto veto power over all agency rulemaking.

OMB's authority over agency regulations is further bolstered by the Paperwork Reduction Act of 1980, 44 U.S.C. § 3501 et seq., which gives OMB authority over regulations that require the collection of information. The Act confers on OMB the authority, under certain circumstances, to curb an agency's efforts to furnish itself with information if OMB concludes that the collection of information is "not necessary for the proper performance of the functions of the agency." 44 U.S.C. §§ 3504(h), 3508. The Act prescribes a procedure to be followed by an agency that contemplates promulgating a rule containing "collection of information requirements." No later than publication of a Notice of Proposed Rulemaking involving such requirements, the agency must submit a copy of the proposed rule to OMB. § 3504(h)(1). OMB then has sixty days in which to file public comments on the "collection of information requirement[s]" in the proposed rule. § 3504(h)(2). In publishing a final rule, the agency must "explain how any collection of information requirement contained in the final rule responds to the comments, if any, filed by the Director [of OMB] or the public, or explain why it rejected those comments." § 3504(h)(3). Within sixty days after the publication of the final rule, OMB may disapprove any collection of information requirement contained in the rule if it finds the agency's response to its comments was unreasonable, or if it finds that the agency's modifications of the rule to meet OMB's objections are not adequate. §§ 3504(h)(5)(C) & (D).[1] The effect of a disapproval is to render the collection of information requirement unenforceable: no person may be penalized for failing to comply with such a requirement. § 3512.

Taken together, these powers give OMB substantial, if not decisive, control over an agency's rulemaking process from start to finish. Under the two Executive Orders, OMB has the power to supervise the development of all regulations, and under the Paperwork Act, OMB can control the ability of an agency to gather information -- which obviously can have a profound impact on the agency's ability to carry out its substantive mission. OMB's hegemony cannot be doubted. As Jim Tozzi, the former Deputy Director of OMB's Office of Information and Regulatory Affairs ("OIRA") noted: "The government works using three things: money, people, and regulations; the agency must get all three from OMB." Olson, The Quiet Shift of Power: Office of Management and Budget Supervision of EPA Rulemaking Under Executive Order 12,291, 4 Va. J. Nat. Res. L. at 6 (1984). When asked to name an agency that promulgated a regulation over OMB's objection, then OIRA Administrator, now Circuit Judge, Douglas H. Ginsburg responded,

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[1] It should be noted that, by allowing OMB to disapprove the information collection requirements of a regulation *after* the regulation's issuance, the Paperwork Reduction Act often hampers judicial review. Although we recognize that this is not an area the Committee is currently focusing on, we urge that it consider this problem in the near future.

"I don't think that there is such an instance . . . No, none." Earley, What's a Life Worth, Washington Post Magazine, at 11, 37 (June 9, 1985). Or, as the current OMB Director James C. Miller, III, put it, "[i]f you're the toughest kid on the block, most kids won't pick a fight with you. The executive order establishes things quite clearly." Regulation, at 19 (March/April 1981), reprinted in Role of OMB in Regulation, Hearing Before the Subcomm. on Oversight and Investigation of the House Comm. on Energy and Commerce, 97th Cong., 1st Sess. 216 (1981).

Indeed, under this troika of authority, OMB review and approval is now required at least four times before a regulation can be issued and enforced: first, when the agency seeks authorization to place a matter on its regulatory agenda (Executive Order 12498); second, when the agency publishes a notice of proposed rulemaking (Executive Order 12291); third, when the agency publishes a final rule (Executive Order 12291); and fourth, when OMB conducts its final review under the Paperwork Reduction Act. At each juncture, the agency bears the burden of demonstrating that its proposal is not only consistent with the statutory mission assigned to it by Congress, but also with the substantive criteria laid out in the Executive Orders, which mandate that agency rules must be consistent with administration policy and meet stringent cost/benefit criteria. If, in OMB's view, the proposal fails to meet these conditions, the agency cannot regulate, and it has no recourse at all except to withdraw its initiative. With so many opportunities to "just say no" to a regulation, it is hardly surprising that OMB has managed to choke off all but a trickle of health and safety regulations.

Public Citizen has long voiced its opposition to OMB control over the rulemaking process, for three related reasons. First, OMB now has the power to displace decision making authority Congress assigned to expert agencies -- not to the unaccountable economists at OMB. Not only is this displacement unlawful, but in our view, it is bad policy. It makes little sense for untrained OMB bureaucrats to have the power to second-guess the highly technical judgments made by agency experts. Second, OMB control is inherently undemocratic. Our administrative rule making process is a model of openness -- the public has an unqualified right to participate in rule makings, and all agency decisions must be made on the basis of the public record. By contrast, OMB control often is exerted behind closed doors, with no opportunity for public participation and often no public record of what factors influenced OMB's decision. This kind of secrecy is an anathema in a democracy like ours. Third, OMB control denies Congress its vital oversight role. Our Constitution rests on a system of checks and balances, and the framers wisely placed a check on the President's exercise of his authority under the Take Care Clause of Article II through Congress' power to oversee the Executive Branch's work of law-execution. But under Executive Order 12498, Congress will simply never know when an agency sought to develop a regulatory initiative but was blocked from so doing by OMB. That whole process generally takes place outside public view.

In your letter inviting us to appear before the Committee today, you requested that we address four sets of issues relating to OMB's oversight of the administrative process. It is to these issues that we now turn.

The first set of questions relates to whether OMB's present role of regulatory czar is proper from both a constitutional and policy standpoint. As the tenor of these remarks make clear, we strongly oppose this Administration's drive to centralize all regulatory control in OMB, both on legal and policy grounds. Let us first turn to the law.

As the Committee knows, a great deal of attention has been paid to the question of the legality of Executive Order 12291. While there has yet to be a definitive court ruling on that question, there have been several challenges (two of which were brought by Public Citizen's lawyers), and there is at least one lawsuit pending that raises that issue. National Grain and Feed Ass'n v. OSHA, Nos. 87-4960 & 88-4245 (5th Cir., argued June 8, 1988). Because the flaws that have been identified with Executive Order 12291 pervade Executive Order 12498 as well, I will only summarize Public Citizen's legal objection to the Executive Orders, and will refer the Committee to the authorities that discuss the legal question in far greater detail.

The fundamental problem posed by both Executive Orders is that they shift the locus of regulatory decision making power away from the administrative agencies, which have been delegated rule making authority by Congress, to OMB, which has no statutory role in the agencies' rule making mission. This displacement or usurpation of rule making authority flatly contravenes the statutes delegating regulatory authority to the agencies, and hence is unlawful. Congress did not assign any such role to OMB. Indeed Congress has repeatedly refused to enact regulatory reform legislation that would ratify broad OMB or direct presidential oversight of agency rulemaking. *See*, *e.g.*, *Report on the Administrative Procedure Act* (Comm. Print 1945), *reprinted in Administrative Procedure Act: Legislative History*, Senate Comm. on the Judiciary, 79th Cong., 1st Sess. (1946) (rejecting proposal to create "superagency" as part of APA); Rosenberg, *Beyond the Limits of Executive Power: Presidential Control of the Agency Rulemaking Under Executive Order 12,191*, 80 Mich. L. Rev. 193, 221-25 (1981)(recounting subsequent unsuccessful attempts to centralize broad power in OMB); Olson, *supra*, 4 Va. J. Nat. Res. L. at 24 (same).

Nor does the Constitution provide a justification for empowering OMB to play a decisive role in the rulemaking process. It is true that the President is obligated to take care that the laws are faithfully executed, and that he may inquire as to the opinions of his administrative officers, may supervise and guide them, and may remove them from office. But the President's authority over subordinate executive officers is far from absolute. There is no authority to suggest that OMB, an agency that reports to the President, may actually dictate an agenda or prescribe the outcome of a rulemaking to an agency charged by Congress with administrative discretion. Nor can an Executive Order override Congress' judgment that a specific office-holder carry out a specific task -- such as determine an agency's priorities or decide the substantive content of a regulation.

A second set of legal objections to the operations of the Executive Orders stems from the fact that they operate outside of the procedural rules Congress has laid down to govern agency rulemaking. As this Committee knows, when Congress delegates rulemaking authority to an agency, unless it mandates specific procedures that must be followed, the general rulemaking provisions of the Administrative Procedure Act automatically apply. These procedures are designed to ensure that the public is a full and effective participant in the rulemaking process; that agency decisions are made solely on the basis of evidence in the record; and that a complete record is compiled for judicial review. Those procedures do not contemplate any role for OMB, let alone the sort of behind the scenes control OMB exercises under the Executive Orders. All of the determinations OMB makes under the Executive Orders take place not on the basis of a public record, but instead are based on informal, closed-door negotiations with the agency, and whatever outsiders -- often regulated industry -- OMB decides to consult. OMB leaves little or no paper trail. As one high-ranking OMB official put it, OMB tries not to "leave fingerprints" in the administrative record. Washington Post, July 10, 1981, at A21 (quoting OIRA Deputy Administrator Jim Tozzi). Thus, OMB control subverts Congress' intention regarding the nature of the rulemaking process. What courts have long feared -- the "danger of 'one administrative record for the public and another for the Commission'" -- is now occurring every day under the Executive Orders. Sierra Club v. Costle, 657 F.2d 298, 401 (D.C. Cir. 1981), quoting Home Box Office v. FCC, 567 F.2d 9, 54 (D.C. Cir.), cert. denied, 434 U.S. 829 (1977).[2]

If the Committee wishes to explore these legal issues in greater detail, there are a number of excellent materials. Among the most prominent law review articles are those authored by Morton Rosenberg and Erik Olson, which are cited above. One recent article that focuses principally on Executive Order 12984, appears at 38 Admin. L. Rev. 63 (1986). Another article which explores the policy reasons why OMB control is unwise was written by Alan B. Morrison, the Director of Public Citizen Litigation Group, and is published at 99 Harv. L. Rev. 1059 (1986). For the record, we have submitted the brief we filed in National Grain and Feed Ass'n v. OSHA, Nos. 87-4960 & 88-4245 (5th Cir., argued

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[2] Even the few documents OMB places on the public record are difficult, if not impossible, to fine. Anyone familiar with OMB's public information office knows that the designation "public information" is, at best, a misnomer. Either deliberately or through indifference, OMB's "public" files are not organized in any comprehensible, let alone usable, fashion. As a result, it is almost impossible to learn what, if any, written material OMB relied on in its review functions.

June 8, 1988), which addresses the legal issues in depth, and Mr. Morrison's law review article.

The Committee's second question relates to the potential for abuse for "rules in their nascent state," under Executive Order 12498. In this critical respect, Executive Order 12498 is far more insidious than its predecessor. Since Executive Order 12291 only applies to proposed and final rules -- which are typically preceded by advance notices of proposed rulemakings or other public announcements that the agency is exploring a particular issue -- the public at least has an idea when OMB involvement leads an agency to shift its ground or to back away from taking regulatory action. That is why Congress has been able to uncover numerous examples of OMB displacement of agency authority.[3]

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[3] Indeed, the examples of OMB abuse are legion. Some of the most notorious illustrations include:

* OMB forced OSHA to delete portions of its standard governing worker exposure to ethylene oxide. Public Citizen Health Research Group v. Tyson, 796 F.2d 1479, 1483-84 (D.C. Cir. 1986), subsequent opinion, 826 F.2d 626, 627-28 (D.C. Cir. 1987);

* OMB pressured OSHA into delaying and weakening its Hazard Communication Standard. See Office of Management and Budget Control of OSHA Rulemaking, Hearing before the Subcomm. on Manpower and Housing of the House Comm. on Government Operations, 97th Cong., 2d Sess. (1982);

* OMB forced EPA to withdraw proposed rules concerning the banning and phasedown of asbestos use and instead directed EPA to refer action in that area to other agencies -- despite EPA's conclusion that its own action was required by law. See EPA's Asbestos Regulation, Hearings before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 99th Cong., 1st Sess. (1985);

(continued...)

Executive Order 12498, in contrast, operates wholly outside the public's view. By definition, since OMB clearance is an indispensible pre-condition to even listing a particular issue on an agency's agenda, if OMB returns a proposed agency policy initiative under 12498, that would seal the fate of the initiative because it would occur before the agency had begun to gather enough facts to make its case. Consequently, some, perhaps many, rulemaking initiatives will simply disappear, and neither Congress nor the public will ever have a clue that the agency, if left to its own devices, would have explored the facts

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[3] (...continued)

* OMB barred EPA from promulgating standards for hazardous wastes stored in underground tanks, despite a statutory deadline mandating promulgating of such regulations before March 1, 1985. Environmental Defense Fund v. Thomas, 627 F. Supp. 566 (D.D.C. 1986);

* OMB forced EPA to subject health-based air pollution standards to strict cost/benefit analysis in violation of a clear statutory directive that cost/benefit principles should not control. See EPA: Investigation of Superfund and Agency Abuses (Part 3), Hearings of Subcomm. on Oversight and Investigations of the House Subcomm. on Energy and Commerce, 97th Cong., 1st Sess. 81 (1983);

* OMB forced the Food and Drug Administration to delay promulgation of regulations to implement the Infant Formula Act of 1980 -- thereby allowing a substantial amount of defective infant formula to enter the market. See Infant Formula: The Present Danger, Hearings before the Subcomm. on Oversight and Investigations of the House Comm. on Energy & Commerce, 97th Cong., 2d Sess. (1982);

* OMB directed EPA to eliminate a proposed water quality rule, although there was no apparent economic or scientific basis for OMB's objection. See EPA: Investigation of Superfund and Agency Abuses (Part 3), Hearings of Subcomm. on Oversight and Investigations of the House Subcomm. on Energy and Commerce, 97th Cong., 1st Sess. 5-8, 79-83 (1983).

and considered taking regulatory action.

That poses special problems both to Congress and to those interested in seeing that the regulatory agencies carry out their statutory responsibilities. Under Executive Order 12498, Congress is deprived of its right to engage in oversight of the regulatory process. Obviously, one key component of any regulatory program is the establishment of the agency's priorities. But with Executive Order 12498 in place, it is difficult for Congress to accurately determine how agencies are determining their priorities, or selecting areas for regulation. This will plainly impair Congress' oversight function. The public will similarly be in the dark. For this reason as well, few examples of regulations killed as a result of OMB's screening under Executive Order 12498 have come to light.[4] As the Committee appears to recognize in its third question, this is why it is highly unlikely there will be litigation challenging OMB's role under Executive Order 12498 -- we cannot contest the legality of OMB's actions we do not know about and cannot document.

Finally, the Committee requests our views about what future Administrations ought to do in terms of structuring a regulatory review process. In our view, the first principle is that there must be a clear line drawn between the management functions of a regulatory review program, which can be quite valuable, and the usurpation of decisional authority, which is unwise and unlawful. Thus, while I would endorse a role for OMB in coordinating the work of agencies that have overlapping responsibilities, I would oppose any system that vested authority in OMB to substitute its judgment on substantive matters for that of the agency. Moreover, the process needs to be simplified. Applying this Administration's own cost-benefit principles to regulatory review, the present system -- which has a minimum of four layers of review -- is costly and bureaucratic without any benefit to the nation. Regulatory review should be prompt, and not the secret, time-consuming, open-ended process that is now the rule.

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[4] The only examples of which we are aware, which also have been reported in the press, are OMB's refusal to allow the Public Health Service to conduct a study of infant mortality, and OMB's refusal to allow the Occupational Safety and Health Administration to study the effects of a particular toxin on the health of workers at an Adrian, Michigan plant.

Attention must also be paid to the procedures under which OMB operates. The time has come to substitute sunlight for the shroud of secrecy that has masked most of OMB's regulatory oversight work. While we recognize that the Executive Branch generally must be allowed the freedom to exchange its internal views off the public record, on matters affecting the development of regulations or setting an agency's priorities, OMB's comments should be a matter of public record. All documents reviewed by OMB and records of all contacts between OMB and anyone outside the government should be placed on the public record. To the extent OMB wants to file comments with the agency, those comments should also be a matter of public record. And Congress should overrule Wolfe v. Department of Health and Human Services, 839

F.2d 768 (D.C. Cir. 1988)(en banc), which held that records which revealed the extent to which a substantial delay in issuing regulations was attributable to OMB review were exempt from disclosure under the Freedom of Information Act.

Finally, as part of its review of the regulatory process, Congress should not overlook the Paperwork Reduction Act. The automatic sunset provisions of that Act applicable to information gathering rules, added by the 1986 amendments, soon become operative, and Congress needs to reexamine the wisdom of having information collection requirements, such as reporting of defective cars or adverse drug reactions lapse every three years. We urge that this sunset provision be deleted. Congress also needs to examine whether the Act warrants clarification with regard to whether OMB can exert substantive control on an agency's regulatory program through its powers under the Paperwork Act. As this Committee knows, there has long been concern that OMB is overstepping its authority by interfering with an agency's substantive mission by disapproving key information collection requirements. Just such an instance recently ended up in the courts. In a case in which Public Citizen was a party involving OSHA's Hazard Communication Standard, the United States Court of Appeals for the Third Circuit held that: "Nothing in the Paperwork Reduction Act suggests a congressional intention to allow OMB, in the guise of regulating collection of information, the authority to second guess other federal agencies with respect to the kinds of disclosure needed to accomplish the substantive policies entrusted to such agencies." United Steelworkers of America and Public Citizen v. Pendergrass, No. 83-3554 (August 19, 1988). OMB disagrees with this holding. Consequently, it is likely that there will be more litigation over OMB's substantive powers under the Act unless Congress clarifies the limits on OMB's authority.

This concludes my prepared statement. I would be happy to respond to your questions.

Senator John Glenn's
Additional Questions for Joan Claybrook, President
Public Citizen Litigation Group

October 3, 1988

1. Let me ask you about the transparency of the regulatory review process. The June 13, 1988 procedures for implementation of Executive Order 12498 and Executive Order 12291 state that, after the Regulatory Program is published, any agency draft submission sent to OMB will be placed in OMB's public reading room if a written request is made. Has the procedure actually worked this way? Have you, or do you know of others who, had problems getting access to these records? How often are such written requests made?

2. Unfortunately it seems as though a good number of regulatory deadlines are set for agencies by the courts. Without a rulemaking record to consult, would it be possible to litigate regulatory decisions or non-decisions that arise from the Executive Order 12498 process? Have you ever tried to do so?

3. Two principles of the Administrative Procedures Act are that the public, through a notice and comment period, should be given an opportunity to play a role in the rulemaking process; and that the rulemaking process should be conducted in the open, not behind closed doors. With regulatory review under Executive Order 12498, however, the public is not invited to participate in the preparation of agencies' regulatory priorities as presented in the Regulatory Program. Nor is the public invited to comment on the individual "significant regulatory actions" that make up that document. Furthermore, the entire process that leads to the publication of the Regulatory Program is hidden from public view, and there is no rulemaking record that documents this early but crucial phase of the regulatory process. In your view, is Executive Order 12498 a violation of the spirit or intent of the Administrative Procedures Act?

4. Many have asserted that the regulatory review process is excessively secretive, especially under Executive Order 12498. This secrecy may seriously jeopardize the public's confidence that the rulemaking process is guided by reasoned and impartial decision-making. At the same time, however, I recognize that some level of discourse and bargaining within the Executive Branch should be shielded from disclosure lest honest and frank discussion is stifled. Where should we draw the line? How much disclosure of regulatory decision-making under the Executive Order 12498 process makes for good public policy?

5. Executive Order 12498 does not cover the "independent" agencies. Thus, for example, while the FTC and the Antitrust Division of the Justice Department both handle antitrust and regulatory issues, the FTC is not covered by the Order and the Antitrust Division is. Does the fact that Order 12498's coverage is circumscribed in this way undermine its effectiveness for inter-agency coordination?

## Post Hearing Questions to Joan Claybrook
## from Senator Carl Levin

In discussing E.O. 12498, you said in your prepared statement:

"Obviously, one key component of any regulatory program is the establishment of the agency's priorities. But with E. O. 12498 in place, it is difficult for Congress to accurately determine how agencies are determining their priorities, or selecting areas for regulation. This will plainly impair Congress' oversight function. THe public will similarly be in the dark."

Have you or anybody else in your organization requested from OMB copies of the draft regulatory agendas as they are sent by the agencies to OMB for review? Please describe any response.

Are you aware of the Memorandum issued by then OIRA Director Wendy Gramm in June 1986 stating that such draft agendas would be made available to the public? Have you used that Memorandum as a basis for obtaining any draft regulatory agendas?

Do you think making such draft agendas public is helpful in determining the extent to which OMB is affecting the regulatory priorities of executive agencies? Please explain.

PUBLIC CITIZEN

*Buyers Up ☐ Congress Watch ☐ Critical Mass ☐ Health Research Group ☐ Litigation Group*

December 6, 1988

## RESPONSE TO ADDITIONAL QUESTIONS POSED TO JOAN CLAYBROOK, PRESIDENT, PUBLIC CITIZEN, AND DAVID VLADECK, SENIOR ATTORNEY, PUBLIC CITIZEN LITIGATION GROUP BY SENATOR JOHN GLENN REGARDING THE COMMITTEE ON GOVERNMENTAL AFFAIRS' OCTOBER 3, 1988 HEARING ON REGULATORY REFORM

In accordance with Senator Glenn's request for comments on a number of questions relating to our testimony before the Committee on October 3, we hereby submit the following response to the questions presented. Rather than restate each question, we have followed the numbering used by the Committee.

**Response to Question 1:**

This question seeks information about OMB's new practice of making public drafts of proposed and final rules, and agency agendas, following the issuance of final rules and final agency agendas. The question requests information about whether OMB is, in fact, complying with these requirements and whether these drafts are useful for those interested in following the regulatory process.

Insofar as we are aware, OMB has, in general, been adhering to the policy of making drafts available to the public once the agency's action is final. However, the value of these disclosures has thus far been quite minimal. Insofar as we can determine, it appears that the draft made public by OMB is not necessarily the agency's original views on a particular problem, but rather, more often than not, is a draft that reflects some negotiations between OMB and the agency. Thus, it appears that agencies only submit "drafts" to OMB _after_ agency officials and OMB designated officials have reached at least a tacit understanding about the major issues to be addressed in the rule. As a result, the drafts that are revealed to the public reflect some significant degree of OMB involvement, and are certainly not the unfiltered views of the expert agency. We do not know how often such written requests are made.

Response to Question 2:

Before turning to the part of this question which relates to whether it would be possible to bring litigation arising under Executive Order 12498, it is imperative to address the first sentence of the question, which states that it is unfortunate that courts have been setting regulatory deadlines for agencies. We disagree. Under the case law establishing the doctrine of unreasonable delay, it is, in fact, quite difficult for a plaintiff alleging unreasonable delay to obtain any relief at all. Indeed, it is only in the rare case that courts have, in fact, imposed deadlines on agencies. More frequently, courts allow the agency to follow whatever timetable the agency sees fit even if the court is troubled that the delay is harming the public interest.

Turning to the second part of the question, we have not litigated any cases arising under Executive order 12498, nor are we aware of any such litigation brought by anyone else. There are many problems that would be faced in challenging an agency decision or non-decision made under Executive Order 12498. First, of course, there is a standing question. It would be difficult in most cases for a plaintiff to allege a direct and palpable harm that flowed simply from an agency's priority setting under 12498. A related problem stems from the fact that generally one can only challenge final agency action. While a decision to not take action, or to not pursue an important issue might be reviewable, the standards that courts apply in such cases are generally hostile to the plaintiff. The real remedy for the problems presented by the Executive Order is legislation, not litigation.

Response to Question 3:

The third question raises the interesting question of whether Executive Order 12498 conflicts with the Administrative Procedures Act ("APA"). In our judgment, there is a substantial argument that it does, though once again, we are unaware of any litigation raising this question.

The heart of the concern expressed in your question is whether Executive Order 12498, which directs every executive branch agency to engage in priority setting totally outside of public view until it has received OMB's approval, conflicts with the basic principle of the APA that the public should have an opportunity to play a role in all critical decisions by administrative agencies. We certainly agree that in terms of their philosophical underpinnings, Executive Order 12498 and the APA collide head on. However, it is nowhere near as clear that there is a specific violation of the Administrative Procedures Act. After all, agencies are afforded broad discretion in their priority setting and the APA provides no right of public participation until the agency publishes a notice of proposed rulemaking. Thus, while we share the Committee's concern that the secrecy demanded by Executive Order 12498 may serve to subvert the openness required by the APA, we are far from certain that there is a specific violation of any particular provision of the APA.

Response to Question 4:

This question raises perhaps the most difficult policy issue posed by Executive Order 12498; namely, whether there is some value to allowing the Executive Branch to communicate internally without public disclosure. We can all agree that there are limited occasions when it would be counterproductive to require Executive Branch officials to operate in a fish bowl. And, we do not quarrel with the general proposition that at some level, discourse within the Executive Branch should be protected to encourage full and frank deliberation. Thus, we agree with the thrust of the Committee question that at bottom, the issue here is one of line drawing.

We part company, however, with the fundamental directive contained in Executive Order 12498 which categorically cuts off public discussion of the development of priorities. There is nothing inconsistent with allowing the Executive Branch some freedom for internal debate while at the same time soliciting and encouraging the public to participate in that debate. We recognize that the Executive Branch, including OMB, should be allowed to discuss regulatory options shielded from public view before setting an agency's agenda internally. But that does not address the question of whether public comment should be permitted to provide an additional basis upon which the Executive Branch can make its priority determinations. Public participation does not necessarily mean an end to internal Executive Branch deliberation. However, in fulfillment of OMB's 1986 commitment to reveal the agency draft position on priorities, this draft should reflect internal agency discussions without imposition of OMB's views.

**Response to Question 5:**

This question asks our view as to whether the fact that Executive Order 12498 does not extend to independent agencies undermines its effectiveness. The answer, we believe, is that to the extent the Executive Order can be justified on grounds of coordination, the fact that it is limited to executive agencies does hinder, to some minor degree, its functions. However, on the other hand, there are powerful constitutional reasons why it would be inappropriate to extend the dictates of Executive order 12498 to independent agencies. Hence, even if we agreed that the goals embodied in Executive Order 12498 -- which we do not -- we would still have serious reservations about extending it to the independent agencies.

**Response to Question from Senator Levin:**

This question is answered in large measure by our response to Senator Glenn's first question. We are aware of Wendy Gramm's June 1986 memorandum promising that draft agency agendas would be made public, and we have requested disclosure of agendas since that date. We found, however, that the drafts disclosed are documents prepared after some negotiations and tacit agreements between OMB and the agency. Thus, they are not very helpful in revealing differences between agency and OMB views.

# Statement of Richard A. Wegman
Before the
Senate Governmental Affairs Committee

October 3, 1988

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you this afternoon to consider the role of the Executive Office of the President in regulatory management and oversight.

As I understand it, you have asked me to briefly review this committee's efforts to grapple with this question during the 1975-81 period, focusing particularly on the committee's 1977-78 study of federal regulation. You have also asked me to touch briefly upon the findings and conclusions of a recent report by the National Academy of Public Administration on presidential review of agency decision-making. I'll try to conclude with a few of my own thoughts on this issue, and to suggest how regulatory management might be handled in a succeeding administration.

* * * *

In late 1974, shortly succeeding to the presidency, Gerald Ford asked the Congress for authority to undertake a broad scale study of the federal regulatory system. The study would consider how to assess the impact of regulation on the national economy, how to improve and streamline administrative procedure, and how to bring about better coordination among regulatory programs.

After thoroughly considering the Administration's request, this committee decided, in the spring of 1975, to undertake its own study of federal regulation. The study, which was conducted jointly by the Governmental Affairs Committee and the Senate Commerce Committee, took four years to complete. I believe today it is regarded as one of the most comprehensive studies of federal regulation ever undertaken by the U.S. Congress.

A major topic addressed in the study was the coordination issue, and the potential role of the President and/or OMB. The report considered the key role that OMB could play, as "the preeminent coordinating mechanism of the Executive Branch." The report noted that "through its authority to advise the President on the most economical and efficient matter to expend appropriated monies, [OMB] exerts significant force in encouraging executive agencies to pursue policies which the Executive Branch supports." However, the report stopped short of making specific recommendations for expanding the power of the President or OMB in overseeing Executive Branch regulatory agency decisionmaking. And in fact it advocated additional autonomy for independent, non-executive branch regulatory agencies, by recommending that such agencies be exempt from any prior clearance by OMB or other executive branch department in submitting legislative recommendations, testimony, or comments to the Congress.

On a government-wide basis, the committees recommended that an enhanced coordination role be given to the General Accounting Office, which should

> "establish mechanisms for receiving comments and complaints about overlap, duplication, redundant regulation, and inconsistent regulatory policies from the public, the agencies, the regulated industry, small business, or the Congress." (Study on Federal Regulation, Volume 5, p. 94)

In cases of organizational conflicts or inconsistent remedies, the committees recommended that the GAO be directed to advise Congress on appropriate legislative action.

The committees also suggested that Congress become much more actively involved in reviewing planning and priority-setting by agencies. The Joint Study recommended that each agency be required to submit periodically a list of goals and priorities to its congressional authorizing committee, which would determine whether they were fully consistent with the agency's statutory mandate.

As I recall, there was considerable skepticism on both committees at the time about a potentially stepped-up role for OMB in regulatory decision-making. On the one hand, it was recognized that conflicts, overlaps, or inconsistencies could exist between regulatory programs, and that a mechanism was needed to balance among competing priorities, and to iron out conflicts and inconsistencies. On the other hand, there was concern about the administrative process -- and in particular about the impact upon the notice-and-comment provisions of the APA if direct political intervention were to take place after the close of the public comment period. There was also concern over potential displacement of the authority of regulatory officials, whose ability to carry out their statutory responsibilities might be impaired.

Upon completion of the Joint Study in 1978, Chairman Abe Ribicoff (D-Conn), Ranking Minority Member Charles Percy (R-Ill) and other members of the Committee introduced omnibus regulatory reform legislation (S. 1080, 96th Congress). Among other things, the legislation was designed to streamline the administrative process, to clarify separation of functions between agency enforcement and adjudicatory functions, and to limit the tenure for adminstrative law judges.

During its hearings, the committee devoted a considerable amount of time to the coordination issue, and to the proper role for OMB. This was perhaps the single most difficult issue the committee dealt with in the bill. An approach which emerged toward the end of the committee's work would have provided for OMB to "monitor" the rule-making functions of executive-branch regulatory agencies. However, time ran out in the 96th Congress before the bill could be brought to the Senate floor, and the legislation was never enacted.

That session of Congress did see action on two more limited pieces of legislation that have had an impact on the regulatory process -- the Regulatory Flexibility Act (5 U.S.C. 601), which requires agencies to take particular account of the effect of their actions upon small business, and the Paperwork Reduction Act (44 U.S.C. 3501), which reassigned oversight responsibility for information requests from the GAO to the OMB. The Paperwork Act, in particular, has been used to justify much of the regulatory managment program subsequently adopted by the Reagan Administration.

There is little need to dwell at length on the oversight and coordination programs that have been put in place by executive order. Beginining with E.O. 12044 of the Carter Administration (1978), and extending through E.O. 12291 (1981) and E.O. 12498 (1985) of the Reagan Administration, a mechanism has been put in place in the EOP for overseeing the functioning and operation of federal regulatory programs. Executive branch regulatory agencies are required to submit goals, priorities, and program agendas to OMB on an annual basis for approval, and any subsequent modifications must be approved by OMB. Agencies are required to prepare regulatory analyses on all "major" regulatory initiatives assessing the costs and benefits of anticipated action. Agencies are also required to determine that any "given regulatory venture is consistent with the goals of the Administration".

In theory, these objectives are entirely laudable. Regulatory agencies -- particularly those in the executive branch -- serve as part of an elected administration, and should act to further its goals and priorities. And it is unquestionably useful for agencies to have a sense of the anticipated costs and benefits of regulatory action before any action is implemented.

In practice, however, the process under the current E.O. 12291 and 12498 poses a number of problems. Other witnesses have thorougly documented these problems, and they have also been aired in a recent report by the National Academy of Public Administration entitled "Presidential Management of Rulemaking in Regulatory Agencies" (January 1987). Let me just briefly touch on a few of these problems that seem especially significant:

- Delay. Delay has been endemic in the regulatory management process. A recent district court decision documented the delay problem in the case of one agency, the EPA. It found that more than half of EPA regulations subject to statutory or judicial deadlines that were submitted to OMB -- 86 out of 169 regulations -- were delayed beyond the time allowed under E.O. 12291. The average delay was 91 days; total delays amounted to 311 weeks. (Environmental Defense Fund v. Thomas, 627 F. Supp 566, 571, D.D.C. 1986). Most other agencies subject to the Executive Order have encountered similar problems;

- Displacement of authority. A series of reports issued by the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee demonstrate how OMB action has suspended or delayed health, safety, consumer and environmental regulations, often contravening the express intent of Congress that the health, safety and consumer interests of American citizens be protected. (See, e.g., Report on a Case Study on OMB Interference in Agency Rulemaking, H.R. Rep. No. 538, 95th Cong., 1st Sess., 1983);

- Unfulfilled statutory mandates. As the recent NAPA report found: "It is surely true, as alleged by OMB's critics, that laws enacted in one spirit -- one of regulatory zeal -- are being administered in quite another spirit by the Reagan administration. A reading of the enabling statutes of regulatory agencies makes it clear that Congress intended agencies to regulate aggressively. The statutes incorporate extremely broad goals. They demand that the discharge of pollutants into navigable waters be reduced to zero, that worker health not be impaired, that the public's health be protected, that no cancer risks be permitted, and that the latest technologies be employed. These goals, when combined with statutes that specify in great detail substances to be regulated and deadlines for the issuance of regulations, indicate that in many cases agencies may not be issuing enough regulations (OTA, 1985). The EPA, for example, has fallen far short of promulgating the number of regulations that Congress has mandated by statute. (Kirsten, 1986). The OMB bias against new regulatory activity conflicts with the statutory mandates of these agencies." The NAPA report goes on to raise the question whether this is an appropriate exercise of delegated discretion;

- Undermining administrative process. As the NAPA report indicated, the Administrative Procedures Act -- which governs virtually all administrative rulemaking -- has several important purposes. These include (i) providing an opportunitiy for the public to participate in the proceeding, (ii) enabling those affected by a regulation to understand the basis of decisions that are made, (iii) assuring that decisions reached by the agency are reasonable, (iv) assuring that decisions reached by the agency are made according to criteria intended by law -- not the result of political pressures and bargains but based on factors and considerations mandated by Congress, and (v) assuring that the record is open to public

> and judicial scrutiny. The E.O. 12291 and 12498 process, by involving officials not directly charged with administering the underlying statutes, by introducing off-the-record discussions on matters central to the decision-making process, and by introducing potentially extraneous factors for consideration (e.g., cost-benefit criteria, consistency with Administration goals and priorities, etc.), risks running afoul of at least the spirit, if not also the letter, of the APA.

The next Congress and the next administration will have to deal with these concerns. If they do so, they will complete the process begun in the mid-1970's, when Congress and the administration first focussed seriously on problems of overlap, duplication, and inconsistency in the regulatory arena, and recognized that better coordination and management was needed. It is unfortunate that Congress failed to respond to the need for legislation at the time the problem was first recognized, because this forced (or allowed) the executive branch to proceed on its own.

In my judgment the pendulum has now swung too far in the other direction. In the interests of better regulatory coordination and management we have permitted widespread political intrusion into the regulatory proecess to take place; the entire process has become cumbersome and excessively bureacratic; and there is now serious question whether the rule of law is being properly carried out in a number of cases.

I hope very much that the next administration will work with the incoming Congress to craft a statute that addresses these concerns, to provide needed coordination and management while maintaining a process that is viewed as open, objective, and legitimate. Among the matters a statute should address are the following:

1. Should regulatory analysis be employed, and if so, to what extent? As noted earlier, there have been complaints that regulatory analysis has inhibited many health, safety, and environmental initiatives. In my view, regulatory analysis is a useful tool which enables agencies to anticipate the consequences of a proposed regulatory action. But there is a major difference between using regulatory analysis as guidance, and mandating that an agency choose "the alternative involving the least net cost to society" (E.O. 12291). The analysis should simply serve one factor among many that the agency considers before it decides how to proceed -- nothing more than that.

2. How large should the OMB oversight office be? What magnitude of resources should it devote to to task? Much of the displacement of authority problem has arisen because the OMB bureaucracy has grown far larger than it should be. There is no need for OMB to superintend every aspect of the regulatory process, from inception through implementation. Yet that is what E.O. 12291 and 12498 seem to contemplate. If I were writing the statute, I would shift the locus of regulatory decision-making back to the agency head, and limit OMB to the role of arbiter and coordinator. In addition to streamlining the process, this will make it much easier for Congress -- acting through its authorizing commmittes -- to hold agency officials accountable for decisions that are made (or not made). Today it is often very difficult to determine who in the administration is responsible for a decision (or non-decision); this of course can significantly undermine political accountability.

3. Should OMB become involved in particular regulatory decisions, and if so, on what basis? Here again, I believe OMB involvement in particular decision should be the exception, rather than the rule that it

appears to have been in the present administration. Only if a specific action is likely to conflict in a major way with the mission or goal of another administration program or agency should OMB become involved (I do not think this should happen more than 15 or 20 times over the course of a president's term). In such an instance, the OMB involvement should be as open as possible, and take place as early in the process as possible. Interested parties should have an opportunity to respond or rebut the position presented by OMB. In the exceptional situation where the conflict could not have been identified until after close of the notice-and-comment period, and OMB needs to weigh in at this later stage, I would suggest that an additional comment period -- not to exceed 15 days -- be provided so that interested parties would be able to respond to the OMB position.

* * *

Mr. Chairman, we have been seeking an appropriate regulatory coordination mechanism for more than 15 years. If the next Congress can succeed in striking the proper balance, I think a major area of conflict between Congress and the Executive Branch can be eliminated, and regulatory programs can resume functioning as I think Congress intended when it enacted the Administrative Procedures Act back in 1946.

Thank you very much. I would be pleased to answer any questions you may have.

Richard A. Wegman
Answers to Additional Questions
of Senator John Glenn

Q1. Executive Order 12498 does not cover the "independent" agencies. Thus, for example, while the FTC and the Antitrust Division of the Justice Department both handle antitrust and regulatory issues, the FTC is not covered by the Order and the Antitrust Division is. Does the fact that Order 12498's coverage is circumscribed in this way undermine its effectiveness for inter-agency coordination?

A1. I see nothing wrong with exempting independent agencies from coverage under E.O. 12498. Many of the E.O. 12291 and 12498 purposes-- e.g., potential benefits should outweigh potential costs; "the alternative involving the least cost to society" should be chosen-- have little or nothing to do with interagency coordination and avoidance of conflict. With respect to these other major purposes, where an independent agency is concerned, the choice of a regulatory approach ought to be up to the agency charged with administering the statute, not to the Office of Information and Regulatory Affairs. If the scope of E.O.s 12291 and 12498 were narrowed, and their purpose limited to criteria clearly established by statute, it might be possible to bring the independent agencies within their scope. But under the present orders, I would not recommend it.

Q2. Many have asserted that the regulatory review process is excessively secretive, especially under Executive Order 12498. This secrecy may seriously jeopardize the public's confidence that the rulemaking process is guided by reasoned and impartial decision-making. At the same time, however, I recognize that some level of discourse and bargaining within the Executive Branch should be shielded from disclosure lest honest and frank discussion is stifled. Where should we draw the line? How much disclosure of regulatory decision-making under the Executive Order 12498 process makes for good public policy?

A2. Although all the details of communication between an agency and OMB at the pre-rulemaking stage probably should not be disclosed (any more than the discourse and bargaining that takes place within an agency prior to initiation of rulemaking should be disclosed), the public should know who is actually making the decisions about whether and how to proceed on a particular rulemaking. Congress should require that these basic decisions be disclosed-- this will tell us which agency to hold accountable, and whether authority that has been specifically delegated to an agency has been displaced by OMB.

Q3. Two principles of the Administrative Procedures Act are that the public, through a notice and comment period, should be given an opportunity to play a role in the rulemaking process; and that the rulemaking process should be conducted in the open, not behind closed doors. With regulatory review under Executive Order 12498, however, the public is not invited to participate in the preparation of agencies' regulatory priorities as presented in the Regulatory Program. Nor is the public invited to comment on the individual "significant regulatory actions" that make up that document. Furthermore, the entire process that leads to the publication of the Regulatory Program is hidden from public view, and there is no rulemaking record that documents this early but crucial phase of the regulatory process. In your view, is Executive Order 12498 a violation of the spirit or intent of the Administrative Procedures Act?

A3. As I indicated in my testimony, most of what has taken place with E.O. 12291 and 12498 seems to run counter to the public comment process contemplated by the APA. In my view, Congress should determine to what extent the early stages of regulatory decision making-- including the preparation of the Regulatory Program-- should be carried out without public input. Once it has done so, it should enact whatever changes may be required in the APA, to ensure that practices used in the future are fully consistent with applicable law.

Q4. Let me ask you about the transparency of the regulatory review process. The June 13, 1988 procedures for implementation of Executive Order 12498 and Executive Order 12291 state that, after the Regulatory Program is published, any agency draft submission sent to OMB will be placed in OMB's public reading room if a written request is made. Has the procedure actually worked this way? Have you, or do you know of others, who had problems getting access to these records? How often are such written requests made?

A4. Although I have had no direct involvement with the process, I understand from others who have that the OMB public access procedures have not worked very well. Apparently the biggest problem with access to E.O. 12498 materials has been that they are not logged in, dated, or filed in any order. It is very difficult to ascertain what is a preliminary agency draft, an OMB edited draft, an agency edited draft, or a final draft. The OMB files also do not contain any memos or correspondence between OMB and the agency regarding issues raised during the regulatory planning process.

In terms of access to E.O. 12291 material, there appear to be two other significant problems. First, there is no timely or sequential filing of outside comments received by OMB on E.O. 12991 review matters. It is very difficult to get an accurate picture of who is communicating with OMB about what. A second concern is that in the case of E.O. 12498 review, OMB does not release agency material that may accompany or relate to draft rules submitted for review. This would include, for example, agency supplementary letters or responses to OMB questions or concerns about specific regulatory provisions. Except for the rare occasion when the OIRA Administrator writes a final explanatory letter to the agency head, the public is left with only two regulatory documents (i.e., the draft rule and the proposed rule published in the Federal Register) that must be scrutinized line by line by an expert on the subject in order to identify, let alone understand, the impact of OMB regulatory review on the rulemaking decisions.

Q5. Unfortunately it seems as though a good number of regulatory deadlines are set for agencies by the courts. Without a rulemaking record to consult, would it be possible to litigate regulatory decisions or non-decisions that arise from the Executive Order 12498 process? Have you ever tried to do so?

A5. I have no direct experience in litigating decisions arising under the E.O. 12498 process. However, I would expect that the failure of rulemaking records to reflect the degree of OMB involvement in regulatory decision-making would make it very difficult to litigate on the OMB interference issue.

# Testimony on the Regulatory Review Process before the U.S. Senate, Committee on Governmental Affairs

by

W. Kip Viscusi
George G. Allen Professor
of Economics
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October 3, 1988

Mr. Chairman, thank you for the opportunity to testify here today. My name is W. Kip Viscusi. I am the George G. Allen Professor of Economics at Duke University. I would like to begin my testimony by commending you for holding hearings on this issue. Regulatory oversight is not a particularly flashy topic since it is somewhat abstract in character. Nevertheless, the design of this oversight process has fundamental implications for how a broad range of governmental regulations affect our lives. The future direction of this oversight process has far-reaching implications for the role of regulation in our society.

My background in the regulatory oversight area began in the Carter Administration. I was Deputy Director of the President's Council on Wage and Price Stability, which was the branch of the Executive Office of the President that was assigned responsibility for making regulatory filings on behalf of the Executive Office of the President. In addition, this process was accompanied by the activities of the Regulatory Analysis Review Group, which was a non-binding review process for selected major regulations.

During the Reagan Administration, I have been involved in the regulatory process in different capacities. First, I have served as a consultant on various regulatory analyses prepared for OSHA and EPA. In addition, after the OSHA hazard communication regulation was rejected by OMB and then appealed by

OSHA to Vice-President Bush, I was asked to evaluate the substantive dispute between the two agencies. This involvement gave me an opportunity to observe first-hand the operation of the current oversight process. In addition, much of my academic research has been directed at refining my estimates of the value of life and the valuation of other health outcomes. These numbers are now widely used by OMB and in the benefit calculations performed by risk regulation agencies.

The most fundamental issue is whether there should be some form of regulatory oversight mechanism to review and coordinate regulatory activities. All presidents since President Ford have recognized the need for such a process, and I think that there can be little doubt that there is a need for executive oversight. Special interest agencies that are not subject to any outside review other than judicial reviews for overstepping their mandate do not always act in the national interest. There will be a tendency for these agencies to advance their parochial interests rather than the national interest. Congress does not review each regulation that is proposed and does not even have a formal review role. In the absence of an executive oversight process, the White House and the rest of the executive branch would not have a review check either. I believe that the review process is essential simply to get the agencies to advance the national interest rather than the interests of special groups.

In addition, the review process helps to foster coordination of agency activities in situations where there are important overlaps. In recent years, for example, OMB has been involved in coordinating the respirator policies which have been on the agendas of the Occupational Safety and Health Administration, the National Institute for Occupational Safety and Health, and the Mine Safety and Health Administration. There are often situations in which coordination is important, and some centralized oversight process is required to achieve this coordination.

If there is a need for an oversight institution, the issue then becomes which institution should undertake this function. Before the Reagan Administration, the main participants in the oversight process were the Council on Wage and Price Stability and the President's Council on Economic Advisors. The transfer of these functions to the Office of Management and Budget is a desirable change from the standpoint of giving the oversight mechanism more leverage. The Council of Economic Advisors, for example, remains largely an advisory body with no strong institutional base of its own. Fron the standpoint of having an effective oversight process, the shift to OMB is desirable.

The one potential danger from this institutional shift is that there may be greater polilitieization of the oversight process. Many of the participants in earlier eras of the oversight procedure were academic economists on leave to the government who were interested primarily in developing sound economic analyses of policy issues, not in advancing a political agenda. The thorough nature of the regulatory analyses that were prepared also attracted some of the leading career government economists to the regulatory review staff. Although the entire Carter Administration regulatory oversight staff was transferred to OMB at the start of the Reagan Administration, many of the Ph.D. economists have left, and these have not been replaced. My general sense is that the character of the operations has changed substantially as well, as there is less refined analysis of policy issues than there had been in the past. Thus, the process that now occurs is less detailed in terms of the substantive content of the review, and as a consequence it may be less likely to lead to correct decisions.

The criteria for evaluation that have been stated under Executive Order 12291 are quite desirable from an economic policy analysis standpoint. Ideally, we would like to assess whether government regulations best advance society's interests. Making such an assessment requires that we evaluate the benefits and the costs of these regulations, and provided that there are no specific legislative prohibitions against doing so, the regulation should also be subjected a benefit-cost test. We should not proceed with a regulation unless the benefits are greater than the costs. For the most part, it is not the benefit-cost criterion that is applicable. Rather, the dominant emphasis of the review process is on the importance of cost-effectiveness analysis, as an effort is made to find the least expensive means for achieving a particular policy objective.

I fully support the stated criteria for OMB review, and I believe that better policies will result from application of these criteria. The dividends from systematic analysis are often dramatic. When serving as a consultant on the regulatory analysis for a proposed OSHA ethylene oxide standard, I did a detailed analysis of the benefits and costs of successive tightening of the regulation and found that for the last incremental tightening of the standard that was being proposed there were no additional gains in terms of cancer cases prevented. If OSHA had focused only on average benefits and average costs, the regulation would appear to have been effective, but by focusing instead on marginal benefits and marginal costs we could distinguish what extra gains would be achieved from additional stringency in the regulation, which in this case were 0. Policy analyses of this type I believe are essential to formulating a sound regulatory program.

One might raise the issue of whether in fact OMB truly applies such unbiased criteria or whether it simply manipulates such criteria to advance the political agenda of a particular administration. Based on my involvement in the OSHA hazard communication issue, I believe that the character of the debate between the two agencies is exactly what we would want. The main issues at stake were how many additional injuries and illnesses would be prevented by the proposed labeling standard. The concern was whether the health benefits achieved would be worth the costs. Although I believe the functioning of the oversight process was exemplary in this particular instance, the general aura of secrecy breeds suspicion. The issue of making better known what OMB is actually doing is the most important topic for possible reform of the process. I will return to this issue when making my policy proposals.

The most recent addition to the structure of the oversight process is Executive Order 12498, which provides for OMB review of the regulatory agendas of the regulatory agencies. The prospect of this agenda review process was disturbing to many regulatory agencies, but I believe that the reality of the review process has not had the sweeping effects that were feared. It is difficult to kill a regulation at an early stage unless it is obviously undesirable. At the nascent stage there is little information about the benefits and costs of the regulation so that it is difficult to disprove the agency's position that the regulation might be potentially desirable except in extreme situations.

Some of the original proponents of this agenda review process envisioned that it would eventually lead to a regulatory budget. I believe that the regulatory budget concept is not workable and should not be a long-term objective. It is not particularly sensible to impose a budget since we should be interested in pursuing all regulations with benefits to society that are in excess of the costs that we impose upon society, irrespective of whether we have set a particular budgetary allotment for the agency.

It would, however, be desirable to establish a more meaningful discussion of the regulatory agendas of the different agencies. What I envision here is not a brief 5-10 paragraph description of each of the agency's program that we now receive in the Regulatory Program of the U.S. Government. Rather, I would like to see a detailed discussion of how the agency will choose to allocate its resources over the coming years. What should be the emphasis on acid rain, the greenhouse effect, or more immediate risks to society from pesticide exposures? These are questions not so much for a secretive review process but rather for a more open policy debate. In addition, what is needed is not another executive order but a commitment by the leading officials of the agencies and by the Executive Office of the President to raise these issues in a meaningful way and to open them up for public debate.

This suggestion is related to what is my main policy proposal regarding the oversight process. The most important reform that is needed is to open up the current secretive reviews by OMB. After each review, OMB should be required to make public a detailed discussion of either why it has approved a regulation or why it disproved the regulation.

Preparing and disseminating such written assessments is important for several reasons. First, it forces the officials in the agency to think through what regulatory policies are in fact best, as opposed to acting on what may be a political disposition against particular types of regulations. In many cases, one simply does not know the answer as to whether a particular regulation is desirable until a detailed analysis has been performed. In the Carter Administration the preparation of such analyses served as the vehicle for fostering an often intense internal debate as to what our regulatory position should be. By requiring that these analysis be made public, the agency will have a greater incentive to ensure that the underlying policy analyses that form the basis for its regulatory actions are sound and can withstand public scrutiny.

Making these analyses public would also foster the public debate on these issues and provide guidance both for individuals in the agency as well as for officials in other agencies of the proper approach to regulatory analysis. We will know why the government has chosen a particular course, and if new information develops that might alter the attractiveness of the regulation then it will be possible to assess what difference this information will make.

In effect, my proposal is to combine the best elements of the Carter approach and the Reagan approach. What I would like to see is the structure of the Reagan Administration process combined with the substantive emphasis of the Carter oversight process. There should be a greater emphasis on more detailed regulatory analysis, and OMB should make public the nature of its efforts to foster an open regulatory debate.

Senator John Glenn's
Additional Questions for W. Kip Viscusi
Professor of Economics, Duke University

October 3, 1988

1. Executive Order 12498 does not cover the "independent" agencies. Thus, for example, while the FTC and the Antiturst Division of the Justice Department both handle antitrust and regulatory issues, the FTC is not covered by the Order and the Antitrust Division is. Does the fact that Order 12498's coverage is circumscribed in this way undermine its effectiveness for inter-agency coordination?

2. Many have asserted that the regulatory review process is excessively secretive, especially under Executive Order 12498. This secrecy may seriously jeopardize the public's confidence that the rulemaking process is guided by reasoned and impartial decision-making. At the same time, however, I recognize that some level of discourse and bargaining within the Executive Branch should be shielded from disclosure lest honest and frank discussion is stifled. Where should we draw the line? How much disclosure of regulatory decision-making under the Executive Order 12498 process makes for good public policy?

3. Let me ask you about the transparency of the regulatory review process. The June 13, 1988 procedures for implementation of Executive Order 12498 and Executive Order 12291 state that, after the Regulatory Program is published, any agency draft submission sent to OMB will be placed in OMB's public reading room if a written request is made. Has the procedure actually worked this way? Have you, or do you know of others who, had problems getting access to these records? How often are such written requests made?

Response to Senator John Glenn's Additional Questions of October 18, 1988

1. Under the Carter Administration, the Council on Wage and Price Stability did have legal authority to make regulatory filings before independent regulatory agencies. This power was granted by the legislation establishing the Council on Wage and Price Stability, which gave the Council the ability to make filings both on behalf of itself and on behalf of the Regulatory Analysis Review Group. Thus, the White House oversight effort had a formal mechanism for making its views known before independent regulatory agencies, although the degree of its authority was nowhere near as great as that which OMB now possesses over executive branch agencies.

There are two advantages to having such authority. First, in terms of the scope of the regulatory oversight, it is an important restriction if one cannot have any oversight of independent regulatory agencies. There is no reason to believe that independent agencies will be any less susceptible to being captured by special interest groups or to being occasionally misguided in terms of their policies. Some formal review process of this type is essential to provide guidance to the agencies. A second rationale for inclusion of independent regulatory agencies in the review process is that policy overlaps may occasionally emerge. The common responsibilities of the FTC and the antitrust division of the Justice Department, which you alluded to in your question, are a case in point. Regulatory overlaps of this type are not the norm, but when they do arise ideally one would like to employ the most effective regulatory mix possible. In addition, coordination is important so that firms are not hit twice by conflicting or overlapping regulations.

Ideally, one would like to extend the authority of the current regulatory oversight process to include independent regulatory agencies as well. I am not sure what the best legal procedure would be to achieve this outcome, but the objective itself is definitely worth pursing.

2. The issue of OMB secrecy is perhaps the most salient policy controversy before the committee. I am concerned with the secretive aspects, both from the standpoint of legitimacy of the general perception of the oversight mechanism as well as from the standpoint of ensuring that the oversight process does in fact promote the laudable economic objectives that it espouses. The secretive nature of the process began with the Reagan Administration. Before the Reagan Administration, the primary mechanism for expressing the White House views with respect to regulations was through public filings in the regulatory docket. Under the Reagan Administration, there has been a shift from public filings to closed meetings.

The secretive nature of these meetings is at times ridiculously excessive. In one case during the first term of the Reagan Administration I was serving as a consultant to the Occupational Safety and Health Administration, advising them on the benefits of a particular regulation. I was asked by OSHA officials to attend one of their meetings at OMB so that I could explain how they carried out their benefit calculations. However, I was not allowed to participate in the meeting by the paperwork staff since they did not want anyone outside of the two principal agencies involved. This policy appeared not to be a particularly iron-clad rule since subsequently I served as a consultant not to OSHA but to the Office of Management and Budget regulatory oversight group. In effect, OMB can and has manipulated the secrecy aspect of its dealings with agencies both to limit access to its deliberations and to preclude public debate on regulatory issues.

I do not think that it would be fruitful to have a completely open forum. For example, a shift to public hearings in which OSHA presented its case before OMB officials would not be very productive. However, it is clear that we can do much more than we have done to open up the process and to ensure that OMB is in fact applying legitimate economic criteria in its decisions.

What I would propose is that OMB be required to make public a detailed analysis of all regulations that it approves or rejects. This analysis does not have to include a blow-by-blow description of the bargaining that went on between the two agencies. This aspect of confidentiality can be preserved. What it should do, however, is lay out the economic rationale for the policy that has been selected as well as the justification for selecting this policy from the best available alternatives to it.

Preparing such analysis is by no means a daunting task. Under the Carter Administration, we submitted roughly one regulatory filing per week that was of the same level of detail that one would want from the OMB public releases.

Making formal analysis a more prominent part of what OMB has to generate will have the advantage of increasing the internal influence of the professional analysis staff. There have been some periods of OMB operation in which the merits of the analysis did not appear to be the guiding force behind the regulatory decision. Rather, there have been suggestions that the administrator may have had a predisposition with respect to a particular regulation and then asked the analysis staff to justify the position. The potential for abuses of this type is enormous, and we have probably been fortunate thus far in that the regulatory oversight process has been fairly high-minded in terms of its operating style. There is no assurance that severe abuses of this type will not take place in the future, and unless there is some public disclosure of the reasons for OMB actions the public will not know whether such abuses are taking place.

A final benefit from public dissemination of the regulatory analysis is that OMB officials too might learn something from oversight of their activities. By opening these issues up for public debate, including input from Congress, the press, and academic circles, OMB might receive information that will enable it to approach regulatory issues in a sounder manner in the future. This is likely to be particularly important in situations where there are major regulatory uncertainties that are awaiting new scientific input.

3. I have not gone to the OMB reading room to examine the material you have mentioned. Nor do I believe that doing so is a common practice. There are mechanisms for providing for public disclosure of this information. For example, the Bureau of National Affairs keeps track of some of this information and publicizes it among firms so that it is not necessary that all individuals visit the reading room to examine the documents.

It should be noted that this process does not appear to resemble the enthusiastic kind of public disclosure that I recommend. First, OMB does not as a matter of course place all agency draft submissions in the public reading room. Rather, there are obstacles put in the place of this process as the individual must make a written request to examine these documents. Thus, an individual must know what he is looking for and be willing to incur the time cost and the delay of waiting to see his request fulfilled.

In addition, knowing the agency's original position is at most 1/3 of the information we would want. The second missing piece is the reaction of OMB, and the final missing ingredient is the reaction by the regulatory agency to OMB's comments. In effect, what we have here is a minimal disclosure policy that affords us little or no insight into the positions being taken by OMB.

It seems to me that this aura of secrecy is not only not in the national interest, but it is also not in OMB's best interest. I believe that much of the critisim that has been levelled at OMB will be more muted if these critics knew the details behind OMB's regulatory action. At the very least, the debate would shift its focus. Rather than having complaints about OMB acting in dictatorial fashion, we could finally begin to have substantive debates about the mertis of regulatory issues. This would be a much more constructive approach to regulatory oversight policy.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT
of
JAY PLAGER
ADMINISTRATOR
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
in conjunction with
JAMES C. MILLER III
DIRECTOR
OFFICE OF MANAGEMENT AND BUDGET
before the
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
on
Executive Order No. 12498, "Regulatory Planning Process"
October 3, 1988

Chairman Glenn and Members of the Committee -- I appreciate the opportunity to meet with you today. You invited us to testify on the impact of Executive Order No. 12498. More specifically, you asked us to discuss the role of the Office of Management and Budget in the executive regulatory review process, and to describe how the President shapes the priorities of the wide array of regulatory agencies.

E.O. 12498 commits the Administration annually to develop and then publish the Regulatory Program of the United States Government. We have just released the most recent edition -- the 1988 Regulatory Program. This edition includes, in Part I of the volume, an overview of our experience over the past seven and a half years, providing the Congress and the public a summary of our efforts at executive regulatory oversight. This overview addresses many of the issues that you raised in your invitation, and, for that reason, I ask your permission now to include a copy of Part I of the 1988 Regulatory Program in the record of this hearing.

In this Statement, I will summarize the structure and process of President Reagan's regulatory review program, and I will describe what we have done to establish Presidential oversight of Federal regulation as a way of governmental life.

## The Problem

By 1980, the American public faced a complex, inefficient, and constantly expanding system of Federal regulation. Rules controlled virtually every facet of American life and every facet of business enterprise in the country. Over 150 separate Federal bodies had issued thousands and thousands of Federal regulations: only so much of a particular product could go to market; there had to be so much paperwork to track the movement of a particular product or substance considered of interest or concern; a particular product could only be manufactured in certain ways using certain work practices. Hundreds of millions of dollars worth of economic activity were limited, blocked, or absorbed by thousands of new rules every year. Millions of hours of private time and effort were spent complying with Federal reporting and recordkeeping requirements.

It was not at all unusual for different agency rules and data collection requirements to cut across the same activities, creating overlap, conflict, and duplication. For example, at least 15 Federal agencies were involved in regulating toxic substances; at least nine Federal agencies were regulating American transportation.

Thousands of government officials, through the length and breadth of the bureaucracies, were writing, reviewing, rewriting, and litigating Federal regulations. Often only lawyers and specialized regulatory technicians could master their import; on occasion not even they could. The program-focused officialdom often presented agency policy heads with faits accompli -- designing, building, and finishing a regulation with little or no effective top-level review.

Bureaucratic incentives worked against and even undermined effective top-level regulatory management. Technically-minded program advocates had little to gain from coordinating and reconciling their individual -- sometimes personal -- projects with the overall regulatory objectives of the government's political leadership. Issuing a regulation could be a quick way to satisfy a parochial constituent interest. A program advocate could reallocate millions and millions of dollars within the economy simply by seeking issuance of a regulation, rather than by seeking from the Congress through established administrative channels new statutory spending authority, or an appropriation of funds, or new sources of revenue from the public.

## Presidential Task Force on Regulatory Relief

When President Reagan campaigned in 1980, he spoke out against this problem of excessive overregulation. He promised, to use the vernacular, to get the Federal government off the backs of working men and women, consumers, and businesses. He promised to cut the red tape and unnecessary paperwork that the Government imposed on the American people.

Once elected, the President moved quickly to make good on these promises. He established the President's Task Force on Regulatory Relief, chaired by Vice President George Bush. He told the Task Force to spearhead the review and reform of existing rules and paperwork requirements, and to have agencies review existing rules and paperwork requirements dispassionately and revise them if that was the appropriate thing to do. Congress also made a major contribution through the passage of the Paperwork Reduction Act of 1980.

Opening up rules already on the books is generally very difficult. Interests line up for or against an existing regulation. Everybody feels passionately one way or another. Either it is a terrible idea and the regulation should be repealed, or it is the greatest rule ever seen. Lots of money is at stake, and a lot of competitive advantages may come from the way a rule is written. By having placed themselves in a good position under an existing regulation, some enterprises are in a better position to compete with their competitors than if the forces of the market place are allowed to operate.

The Task Force targeted over 100 rules and paperwork requirements, and agencies completed review of most of them by 1983. In August 1983, the Task Force estimated the savings to the economy from rule changes at about $10 to $15 billion dollars over the course of the next several years. Federal reporting requirements were also reduced wherever practicable as part of the effort to ensure that the paperwork burden imposed on the public was kept under control.

## Executive Order No. 12291

The Administration also sought to oversee the growth of new regulations. To accomplish this, President Reagan signed Executive Order No. 12291. Today, it is the centerpiece of Executive regulatory oversight activities.

In pursuance of his constitutional responsibilities to guide and supervise his appointees in the conduct of their Executive functions, the President told his appointees to follow to the extent permitted by law certain regulatory principles. The principles are spelled out in Executive Order No. 12291: agencies are to base regulatory decisions on adequate information concerning the need for and the consequences of proposed regulations; agencies are not to undertake regulatory action unless its benefits outweigh the costs; and agencies are to select the regulatory alternative that involves the least net costs to society. In other words, if agencies have to regulate, they must do so as knowledgeably and efficiently as possible.

Executive Order No. 12291 instructed OMB to oversee agencies' efforts to meet these regulatory principles. Within OMB, this regulatory review authority is carried out by the Office of Information and Regulatory Affairs, the office which I head. In 1987, for example, this Office reviewed over 2,300 draft rules. We found 70 percent were consistent with the President's regulatory principles without any need for change. Another 24 percent were consistent with the President's principles following agency reexamination of the drafts. We returned less than one percent of these drafts to the agencies for reconsideration, and two and a half percent were withdrawn by the submitting agency. The remainder were other cases such as emergency rules or rules improperly submitted. These 2,300 regulations were reviewed in an average of 25 days.

The results of this Executive regulatory oversight have been dramatic. The number of new rules has dropped; the percentage of rules that removed regulatory burdens has increased. Compared to 1980, the number of pages devoted to the issuance of final regulations in the Federal Register in 1987 dropped by 35 percent.

## Executive Order No. 12498

By 1985, it became obvious that more could be done to improve the Federal regulatory system. Despite OMB review of agency draft regulations, and despite the mammoth expenditures Federal regulations exacted from some and the benefits they gave to others, Federal regulations were still being managed far less systematically than we managed direct government spending.

There was no established mechanism for tracking regulations through their often lengthy history to ensure that the President and his agency heads were managing the development of these initiatives. It often takes Federal agencies many years to develop a regulation. Sometimes regulatory development continues through more than one Administration. In fact, we are still seeing rules that were started back in the Nixon Administration, the Ford Administration, or the Carter Administration.

Rules were often being developed by bureaus or offices far down the Department's chain of command, removed from the oversight of the agency's management. Agencies spent a lot of money and used a lot of human resources to have contract studies done and to hold hearings, or to develop special-interest group support for these regulations. Often this work was done to justify decisions already made rather than to collect data in order to make good decisions. Furthermore, analysis detailing the economic impacts of a rulemaking was often absent or inadequate, or, again, constructed to justify rather than help make decisions. This pattern of regulatory development made it very difficult for agency heads to exercise managerial oversight over specific rulemakings. After years of development, a rule would be sprung upon the agency head for his or her immediate concurrence. Then, a week later, it would be sprung upon OIRA for Executive order review.

As a result, President Reagan decided he needed to involve agency heads, policy officials, and the public earlier in the rulemaking process. On January 4, 1985, he issued Executive Order No. 12498, "Regulatory Planning Process," "[i]n order to see that the laws are faithfully executed, and that the policies of this Administration are reflected in the regulations issued under those laws." The Executive Order obligates the Administration to publish, every year, a Regulatory Program. We published Regulatory Programs for 1985, 1986, 1987, and as noted, just recently, for 1988.

The concept and structure of regulatory planning is basically simple: all the significant regulatory actions that an agency has underway -- including the regulatory development projects -- should first be submitted to the agency head before going any further. Those that the agency head thinks are warranted then go to the President, acting through OMB, for review prior to being published in the annual Regulatory Program. Whether an agency plans to issue a significant rule eight years from now, two years from now, or two months from now, the decision is one that needs to be considered as early as possible, and not in a last minute up-or-down ratification.

OMB performs this Executive regulatory planning in a manner similar to the President's budget process. At the beginning of each year, each major regulatory agency drafts a summary of its regulatory policies, and describes specific regulatory projects underway, including final rules, proposed rules and pre-rulemakings. OMB then reviews each agency's draft regulatory program for consistency with the Administration's regulatory policies and priorities, and the draft regulatory programs of other agencies. OMB will also identify further regulatory or deregulatory actions that are necessary to achieve consistency with Administration policy. If OMB and the agency cannot resolve a policy dispute, it is referred to an appropriate forum in the White House and, when necessary, to the President himself. Following this Executive review, the Administration publishes its decisions in the Regulatory Program.

We published the 1988 Regulatory Program this September. Part I of the 1988 Regulatory Program discusses the underlying law and policy that supports the Administration's coordination and review of Federal rulemaking. It also covers such topics as the weaknesses within the Federal regulatory structure, mechanisms for assuring agency adherence to the President's regulatory principles, regulatory policy guidelines, federalism, and the role of economic analysis in the development of regulations.

Part II provides details on the 451 significant regulatory actions of 22 departments and agencies, selected because of their economic importance, policy precedent, and other substantial effect. The Departments of Health and Human Services, Labor, Transportation, and the Environmental Protection Agency account for 60 percent of these actions. For 57 percent of the actions, agencies anticipate issuing a proposed rule within the planning year; 31 percent of the actions will be "final" rules that agencies anticipate will be issued during the year; and 12 percent of the actions are at the early, pre-rulemaking stage.

The 1988 Regulatory Program sets forth what each agency's objectives are, why the agency thinks it must do something at all, and what it is doing to ensure the cost-effectiveness of the alternatives that it does choose.

In these annual publications the Administration has presented, for the first time for all to see, a comprehensive program of upcoming regulatory activity. Annual publication permits Congress and the American people to understand more fully the Executive's regulatory choices and its priorities -- to understand more fully at an earlier stage, long before the publication of any proposed rule, how the Executive intends to exercise the regulatory discretion that Congress has provided it by statute.

An important purpose of the regulatory planning process is to make the agency head personally involved in regulatory policymaking at an early point in the agency's rulemaking process. This planning process also provides agency heads and the Chief Executive a better opportunity to decide whether the regulatory activity is worth starting before committing agency resources to it. As President Reagan stated in issuing E.O. 12498, each agency head became "accountable for the management of the regulatory process, to ensure that policy options are not narrowed prematurely and that each significant regulatory proposal will be considered in relation to others."

## Presidential Authority

Some have questioned whether such Executive oversight and coordination of agency regulatory activities is a proper, or even legal role for the President. They forget that, in essence, Executive Order Nos. 12291 and 12498 simply make more systematic and more formal, and therefore make more public and more visible, the long-standing informal practice by which Executive-branch officials have sought prior White House advice on important and sensitive regulations. Past Administrations and Congresses have endorsed such oversight. Future presidents -- as Chief Executives accountable to the public -- will undoubtedly continue to review and oversee agency regulations.

In conducting regulatory reviews, OMB is carrying out a delegated constitutional authority of the President, carrying out his responsibility as manager and Chief Executive of government. OMB does not supplant the legal authority of the rulemaking agency. Legal authority for issuing regulations remains vested in the head of the agency or department, as provided by law.

The constitutional and legal support for the President's current Executive regulatory oversight program is clear. This President and his three immediate predecessors have, with the acquiescence or active support of Congress, supervised the regulatory activities of their appointees, as they have supervised and guided agency activities in many non-regulatory areas. Each President's Attorney General has advised that he is authorized by the Constitution to perform these functions. Each of the regulatory oversight programs of this and prior Presidents (of both political parties) has been reviewed and determined to be legally valid by the Attorney General.

No court has held any of these Executive regulatory oversight programs to be invalid. Perhaps the most relevant judicial opinion is Sierra Club v. Costle (657 F.2d 298, 405-06 (D.C. Cir. 1981)), which was issued after E.O. 12291 was signed:

> The court recognizes the basic need of the President and his White House staff to monitor the consistency of Executive agency regulations with Administration policy. He and his

> White House advisors surely must be briefed fully and frequently about rules in the making, and their contributions to policymaking considered . . . . The authority of the President to control and supervise executive policymaking is derived from the Constitution; the desirability of such control is demonstrable from the practical realities of administrative rulemaking.

Given some of the concerns I have heard expressed, I am pleased that such diverse groups as the American Bar Association and a Panel of the National Academy of Public Administration have endorsed presidential efforts to oversee and coordinate agency regulatory development. Specifically, on February 10, 1986, the House of Delegates of the ABA endorsed Executive Order Nos. 12291 and 12498 as "appropriate exercises of presidential power," and stated that the President was not only authorized to carry out these regulatory oversight functions, but was required to do so.

In January 1987, a panel of the National Academy of Public Administration issued a report, "Presidential Management of Rulemaking in Regulatory Agencies." This lengthy report carefully describes the history and current forms of Executive regulatory management, and many related issues. In conclusion, the report endorses formal presidential efforts to oversee and coordinate agency regulatory development: "in the absence of Supreme Court decisions to the contrary, ... a regulatory management process, properly constructed, is an appropriate constitutional exercise of presidential power."

I welcome these endorsements of Executive regulatory oversight. Few today would question that Executive Order Nos.

12291 and 12498 have been effective both in removing and reducing unnecessary burdens on our economy and our society as a whole, and also in improving the effectiveness of those regulatory requirements that are imposed.

## Interagency Coordination

In your invitation to testify, you asked us to comment on the need for interagency coordination and regulatory agenda-setting. I have already described in some detail the need for the President and his agency heads to set a regulatory agenda, and how E.O. No. 12498 has helped formalize this process. Interagency coordination is another important function of the President's regulatory review process.

The need for interagency coordination of regulations is inevitable given the complex network of agencies and overlapping statutory authorities that have been created over the past hundred years. For example, numerous agencies review, approve, or inspect food products for safety before they can be sold for human or animal consumption. These include the Animal and Plant Health Inspection Service (APHIS) and the Food Safety and Inspection Service (FSIS) in the U.S. Department of Agriculture (USDA); the Food and Drug Administration (FDA) in the Department of Health and Human Services (HHS); and the Offices of Pesticide Programs and of Toxic Substances in the Environmental Protection Agency (EPA).

Several specific cases with which we have recently been involved illustrate the need for interagency coordination. As the public demands more information on the potential hazards of chemicals, many Federal agencies have initiated regulatory programs to disclose chemical hazard information to workers, to consumers, and to the public. These include the Occupational Safety and Health Administration (OSHA), the Department of Transportation (DOT), the Food and Drug Administration (FDA), the Consumer Product Safety Commission (CPSC), and the Environmental Protection Agency (EPA). Chemical hazard disclosure programs that are not effectively coordinated may lead to a proliferation of information that is duplicative, wasteful, and confusing rather than enlightening and effective. Jurisdictional overlaps have in some cases frustrated the goal of consistency. Without careful coordination as to the type, use and format of data to be collected and disclosed, these programs would be far costlier than necessary and less useful.

Another example of the need for interagency coordination is the regulation of biotechnology research and products. Many different agencies, including the National Institutes of Health, the Food and Drug Administration, the National Science Foundation, the Environmental Protection Agency, and the Department of Agriculture, have responsibilities in this area. Coordination among these agencies is essential to regulate this new field rationally. In the early 1980s, interagency working groups were set up at OMB's request to coordinate science and policy issues related to biotechnology. The result of this effort was a series of joint interagency notices, published in the Federal Register, that defined jurisdictional boundaries and set forth policy statements for each of the agencies involved in biotechnology regulation. Through the Regulatory Program of the United States, OMB and the responsible agencies have continued to track the status of sister agencies' forthcoming biotechnology rulemakings.

Yet another example involves the Animal Welfare regulations developed by USDA's APHIS, currently under review at OMB. In this case, we asked the Interagency Research Animal Committee (including representatives from FDA, EPA, and DOD and DOC, and chaired by the National Institute of Health) to survey their members for data on the costs and impacts to their agencies of the draft regulations. This had not been done as part of APHIS's original submission although the Animal Welfare Act requires this coordination. The member agencies have welcomed the opportunity to review these regulations prior to publication, since their own program and regulations will be affected.

It is not unusual for an agency's program to require the cooperation of different agencies to ensure sensible regulatory programs that do not confuse the regulated community and burden it with conflicting and duplicative regulatory requirements. The Department of the Interior (DOI), for example, regulates off-shore air quality as it affects on-shore air quality, while EPA regulates air quality over the continental land mass. Needless to say the two sets of standards must be compatible, and with many agencies developing anti-drug use programs, coordination of these is also essential.

In all these cases, Presidential oversight of regulation helps ensure that coordination has not only taken place, but that issues between agencies have been resolved so that the total regulatory program is sensible and efficient. All the processes described above have been used to contribute to this coordinating process -- the Task Force on Regulatory Relief, E.O. No. 12291, and E.O. No. 12498 -- and they or something like them will continue to be needed to effectively oversee the massive regulatory machinery of the Federal government.

## Prescriptions for the Future

In another question, you asked if I had any prescriptions for the future on the shape of the executive regulatory review process. To some extent my remarks already suggest my answer -- Presidential oversight and coordination of agency regulatory activity is critical to sound and responsible management of the Government. The President needs to tailor the exact form and structure of these processes to his style and perception of good management. The Constitution gives the Chief Executive the responsibility to manage the Executive branch; to supervise and guide Presidential appointees in the exercise of their executive functions; and to require written opinions on matters within the scope of their responsibilities. The new Chief Executive will have his own views on how he should carry out his constitutional responsibilities to manage the Executive branch.

In other words, executive regulatory oversight is an essential element of sound Presidential management; the form is largely a matter of how the President wishes to manage -- to oversee and coordinate -- his political appointees, those that he (with Senate agreement and confirmation) wants to run the many regulatory agencies and programs.

In my opinion, executive experience over the past two decades suggests the need for the President to:

* Publicly set the overall direction for regulatory agencies by announcing the general, government-wide principles, both economic and social, to which regulatory agencies should adhere as they implement their statutory responsibilities;

* Designate those in the Executive Office of the President who should carry on the day-to-day oversight of agency regulatory developments, with the responsibility to monitor agency activity, to coordinate government-wide issues, to identify issues of concern, and, after appropriate interagency discussion, to bring the remaining issues to the White House for resolution; and

* Establish procedures to assure meaningful review by agency heads and the Executive Office at appropriate points in the process, and provide for full public disclosure of Administration regulatory priorities, and the regulatory plans and programs of the agencies.

Issuance of government regulations is one way to spend private dollars without formally taxing the public to get them. We must not go back to the days of excessive regulation -- of stifling innovation and imposing unnecessary costs on American consumers and businesses. The new President should establish executive regulatory oversight, of a kind and in a form suitable for him, to assure that this does not happen.

Thank you for inviting me, and I welcome the opportunity to answer any questions you may have.

### Senator John Glenn's
### Additional Questions for S. Jay Plager, Administrator
### Office of Information and Regulatory Affairs

October 3, 1988

Question 1. You have heard others testify before the Committee that Executive Order 12498 gives OMB the opportunity to abuse the regulatory review process by imposing--behind closed doors--an administration's ideology on the U.S. regulatory program. Rather than ask you if OMB has actually done this, I am interested in knowing whether you see the potential for such abuse in Executive Order 12498? If so, what can be done about it?

Answer: This question assumes that it would be an "abuse" of the regulatory review process for an administration to "impose" a President's "ideology" on the U.S. regulatory program.

A different view of that idea would suggest that, to the extent that statutes provide the Executive branch discretion to implement individual regulatory requirements, the President and his Administration are obligated to have agency implementation of that statutory discretion reflect the basic policies and "ideology" which the public elected the President to carry out. Otherwise, the President would not be carrying out that for which he was elected, and for which the public will hold him politically accountable. As we wrote in Part I of the 1988 Regulatory Program,

> "As Chief Executive, the President is constitutionally responsible for the day-to-day implementation of all Federal laws by Federal agencies. This gives the President the responsibility and with it the commensurate authority to oversee the development of regulations by Presidential appointees. (p. 11.) * * *
>
> "In addition to the obligation to resolve conflicts and set priorities among statutes, the President also needs to coordinate the implementation of all Federal law with the President's political program that the voters elected him or her to carry out, and to mold both to changing circumstances. The day-to-day course of national affairs generates new issues to which the President must make a coherent response and for the resolution of which the public will hold the President politically accountable." (p. 12.)

It is a basic function of the Office of Management and Budget--in carrying out its budgetary, legislative, regulatory, and other forms of program oversight--to assure, within the discretion allowed by law, that agency activities are consistent with the policies of the President and his Administration. To the extent these Presidential policies reflect a particular "ideology" or perspective on the role and functions of the Federal government, and with that a set of priorities, it is the function of OMB to assure that agencies behave in ways consistent with that "ideology" or set of priorities. This would be true regardless either of the political affiliation of the President or of whether his "ideology" were liberal or conservative.

As you note in Question 3, Executive Order No. 12498 directs the Director of OMB to "consider the consistency of the draft regulatory program [submitted by each agency] with the Administration's policies and priorities and the draft regulatory programs submitted by other agencies" (Sec. 3(a)). This does not constitute an "abuse" of the U.S. regulatory program; instead, this reflects the President's effort to carry out his ongoing constitutional responsibility and duty to oversee agency regulations.

Question 2. Two principles of the Administrative Procedure Act are that the public, through a notice and comment period, should be given an opportunity to play a role in the rulemaking process; and that the rulemaking process should be conducted in the open, not behind closed doors. With regulatory review under Executive Order 12498, however, the public is not invited to participate in the preparation of agencies' regulatory priorities as presented in the Regulatory Program of the United States Government. Nor is the public invited to comment on the individual "significant regulatory actions" that make up the document. Furthermore, there is no open record that documents the crucial decision-making process that leads to the publication of the Regulatory Program. How do these features of OMB's regulatory review process square with the intent and letter of the Administrative Procedure Act?

Answer: The Administrative Procedure Act (APA) provides for the manner in which the public (including affected interests) can review and comment on an agency rule proposed for adoption. It does not establish procedures for agency development of a regulatory proposal. There is a specific time the public is formally invited to comment on a proposed rule to help construct an administrative record,[1] but that happens later. The work leading up to the formal proposal is not controlled by APA procedures.

The regulated public, agency constituencies, and interested Members of Congress have long felt free and are legally permitted to meet with agency staff responsible for developing regulations and to discuss a possible rulemaking prior to any official notice of a proposed rule in the Federal Register. Moreover, they may do so in private, behind closed doors, without a record, without inviting others to attend, without any form of public notice, and without any possibility for public comment at that time. The scope of this practice is widely acknowledged:

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[1] Under the Administrative Procedure Act, a regulatory decision--by statute and by Executive Orders No. 12291 and 12498--is that of the agency head, and the decision must be based on the agency "record." The agency cannot rely on factual information that is not in the agency record to support its decision. Once a regulatory proposal is made, notice is given, public comments are received, and a "record" is compiled that provides a rational basis for the final rulemaking decision.

> "In the practice of administrative law as it has developed over the years, there have been virtually no restrictions on communications with agency officials at the early stages of their consideration of a particular [regulatory] problem. Written information is routinely supplied, meetings are held at which the presentations are made by the regulated industry one day, and those on the other side the next, and the agency has felt free to discuss its tentative views about where a proposal is going and what the agency is considering with any interested group." (Alan B. Morrison, "OMB Interference with Agency Rulemaking: the Wrong Way to Write a Regulation," 99 Harv. L. Rev. 1059, 1068 (1986), quoted in footnote 68 at p. xliii of the 1987 Regulatory Program.)

This situation is one of the reasons for President Reagan's issuance of Executive Order No. 12498. The President issued Executive Order No. 12498 to provide policy guidance and accountability earlier in the process of regulatory development. As we explained in the 1987 Regulatory Program:

> "The problems with regulatory review [under Executive Order No. 12291] stemmed in part from a lack of advance planning. Executive Order No. 12291 reviews often came late in the regulatory process, after huge investments of agency time and resources, and often after agency staff commitments to constituents had made it extremely difficult to consider any legally acceptable, but previously ignored, regulatory alternative. As a result, the bureaucracy often presented agency heads with faits accompli--regulations that were essentially finished with little or no input from those legally and politically in charge. In many cases, agency heads learned about the proposals only just before they were submitted for Executive Order No. 12291 review. These random, occasionally undesirable rulemakings did not always constitute or reflect Administration priorities, nor did they necessarily reflect the regulatory options authorized by law. Most notably, this phenomenon occurred with costly regulations that, germinating and percolating through several Administrations, became creatures seemingly immune to political or policy influence, gaining and retaining a life of their own." (p. xliii.)

Even so, it is not the case that the public is without information about rules under development. Indeed, one of the purposes of Executive Order No. 12498 was to provide the public--and the Congress--with this information. As we stated in the 1985 Regulatory Program:

> "By stating early in the regulatory process, often prior to rulemaking, the general policy considerations and the critical factual issues that the agency head believes will be important in his or her decision, the Regulatory Program should increase the public's opportunity to provide meaningful comments during the rulemaking process.
>
> "To comment on a Significant Regulatory Action (SRA), send your comments to the agency considering or conducting it. Your comments will be considered during any public comment period that follows the publication of [the proposed rule]. (p. xiii.) * * *
>
> "Under Executive Order No. 12498, the Office of Management and Budget provides procedures for assembling the Regulatory Program, coordinates the process, and identifies conflicts among agencies or with the Administration's policies. OMB will review regulations submitted under Executive Order No. 12291 for consistency with the Program.
>
> "If you wish to comment on the Regulatory Program please send your comment on the Regulatory Program to [the] Administrator, Office of Information and Regulatory Affairs [OIRA], ... If your comments address a particular SRA, however, you must send them to the relevant agency in order for it to consider them." (p. xiv.)

As a result of this public notice in the first Regulatory Program, and of subsequent speeches and testimony on this review process, we have received written comments discussing material that has been included, or that the writer thought should have been included, in a Regulatory Program.

Consistent with our public disclosure policy stated in the June 13, 1986 memorandum from the Administrator of the Office of Information and Regulatory Affairs (OIRA), to the Heads of Departments and Agencies Subject to Executive Order Nos. 12291 and 12498, written materials received from anyone not employed by the Federal government are made available in OIRA's public reading room for review by the public. Any comments we have received concerning material published in the Regulatory Program have been filed in OIRA's public reading room.

Similarly, and contrary to another assumption in the question, we do maintain an open record that documents the crucial decision-making process that leads to the publication of the Regulatory Program. OIRA Disclosure Procedure #8 states that:

> "OIRA will make available upon written request to OIRA made after the Regulatory Program is published, any agency draft submission sent to OIRA under Executive Order No. 12498. A copy will be available in the public reading room."

For example, OIRA's public reading room has in a file drawer the draft agency regulatory programs (and any other agency draft submissions) for the 1988 Regulatory Program, and these files are readily available to the public.

Question 3. According to Executive Order 12498, regulatory actions must be "consistent with the goals of the agency and of the administration ...". What happens if the goals of the Administration conflict with the legislative mandate of agencies' organic statutes?

Answer: The legislative mandate rules. Under Executive Order No. 12291, agencies are to adhere to the President's regulatory principles "to the extent permitted by law" (Section 2). OMB is authorized only "to the extent permitted by law" to take such actions as may be necessary to implement Executive Order No. 12498 (Section 4).

Question 4. Does OMB ever solicit technical advice from outside the government as part of the regulatory review process established by Executive Order 12498? If it does, are these contacts logged, and are those logs made part of the rulemaking record?

Answer: OMB does not, and I have been assured has not, solicited technical advice from outside the government as part of the regulatory review process established by Executive Order No. 12498.

## Post Hearing Questions for Jay Plager
## from Senator Carl Levin

Question. In your prepared statement you did not mention former OIRA Administrator Wendy Gramm's memorandum to all executive agencies and departments in June 1986. That memorandum established what I believe are very important public disclosure procedures for OIRA under E.O. 12291. Are those procedures still in effect?

Answer. Yes.

My prepared statement pointed out that Part I of the 1988 Regulatory Program gave an overview of our experience over the past seven and a half years. Rather than repeat all our experience in my formal testimony, I attached this overview to my prepared statement, and asked that it be included in the record of the hearing.

At page 15 of this overview, "OMB Procedures for Implementing Executive Order No. 12291" we summarize compliance by the Office of Information and Regulatory Affairs (OIRA) with Administrator Gramm's June 13, 1986 memorandum. In addition, to help the public understand these disclosure procedures, we published the memorandum itself in Appendix III of both the 1987 Regulatory Program and the 1988 Regulatory Program.

Question. If I go into the public reading room, can I find the draft regulatory agendas of each of the agencies?

Answer. Yes.

OIRA Disclosure Procedure #8 states that:

> "OIRA will make available upon written request to OIRA made after the Regulatory Program is published, any agency draft submission sent to OIRA under Executive Order No. 12498. A copy will be available in the public reading room."

OIRA's public reading room has in a file drawer the draft agency regulatory programs (and any other agency draft submissions) for the 1988 Regulatory Program, and these files are available to the public. The draft agency regulatory programs (and any other agency draft submissions) for previous Regulatory Programs are in storage in a room near the public reading room, and will be made available to the public upon request.

Question. How many agencies have requested that the EPA procedures for disclosure referred to in the memorandum apply to them? These procedures are:

OIRA will send the agency copies of all written material concerning the agency's rules that OIRA receives from persons who are not employees of the federal government;

OIRA will advise the agency of all oral communications concerning the agency's rules, e.g., meetings, phone calls, that OIRA has with persons who are not employees of the federal government;

OIRA will invite the agency to all scheduled meetings with such persons concerning the agency's rules.

Answer. These agencies are listed at page 15 of Part I of the 1988 Regulatory Program, the overview attached to my prepared statement. These agencies are: The Departments of Housing and Urban Development, Labor, Transportation, Treasury, and the Environmental Protection Agency.

Question. How many requests for disclosure do you receive on a monthly basis for copies of draft notices of proposed rulemakings and draft final rules submitted to OIRA for review? and

Question. How many requests for disclosure do you receive on a monthly basis for the written correspondence OIRA receives relative to a rule under review that is exchanged between OIRA and the rulemaking agency?

Answer to both questions. Two to three, on the average. The draft rules and written correspondence referred to are kept in the same files. When we receive requests for disclosure, we provide the contents of the file--both draft rules and correspondence exchanged with the rulemaking agency. When the procedures were first implemented, there were a flurry of requests. Within a month or so, the number of requests dropped to the current rate.

Question. Are these disclosure procedures working, in your opinion? Have you had any complaints?

Answer. These procedures appear to be working. We are unaware of any complaints or administrative problems in complying with these requests.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Honorable John Glenn
United States Senate
Washington, D.C. 20510

Dear Senator Glenn:

I appreciated the opportunity to testify on October 3rd on the Administration's oversight of regulatory activities of the executive branch. An issue that I feel merits further attention is the Office of Management and Budget (OMB) review of the Formaldehyde Standard (FS) promulgated by the Occupational Safety and Health Administration (OSHA). The two concerns that were raised involved an alleged OMB "delay" of the OSHA rule and the possibility of unwarranted OMB "interference" with the scientific conclusions of OSHA staff scientists. Neither concern is supported by the facts of the case.

**Timing of OMB Review:** Over the three-year period that DOL required to develop and complete the formaldehyde rule, OMB review encompassed a total of 25 days. Due to a judicial deadline, the Department did not submit the NPRM to OMB for review under Executive Order No. 12291 (see Section 8(a)(2) of the Executive Order), although OMB did respond to informal drafts while the rule was being developed. Hence, OMB review did not delay the proposed rule a single day.

The final rule was also under a judicial deadline. OMB's review of the final rule encompassed 25 days, and did not prevent the Department from meeting the judicial deadline.

**Substance of OMB Review:** Following publication of the proposed formaldehyde rule, OMB submitted a 94-page filing to the public record. OMB's comments discussed in detail the OSHA proposal and reached the following conclusions:

- OSHA had presented a well-documented case that the acute health risks of exposure to formaldehyde supported a reduction in workplace exposures.
- The findings of the studies contained in the public record suggested that formaldehyde did not pose a significant carcinogenic risk to workers at current occupational exposures, and that Federal action may not have been warranted.

OMB pointed out that the risks from formaldehyde were at least an order of magnitude lower than risks from other substances that OSHA had regulated and lower than risks posed by most American jobs (OSHA's statistical model that best fit the data estimated that the risk of cancer resulting from one year of exposure to formaldehyde at the highest permissible limit was eight out of **ten billion**, which is less than one-millionth the annual risk of a job-related fatality in the retail clothing sector). OMB also pointed out that OSHA's risk estimates were extremely sensitive to certain assumptions, discussed the case for and against those assumptions, and showed how the risk estimates would change if different assumptions were made. In addition, OMB compared OSHA's approach to the approach recommended for government-wide application by the Office of Science and Technology Policy in its 1985 risk assessment principles. These analyses suggested that even the low risks estimated by OSHA may have been substantially overstated. It was important that these points, which had not been made by OSHA staff scientists, be explicitly discussed on the record so that OSHA's decision-makers and the public would proceed with a full understanding of the relative risks of formaldehyde and the uncertainty underlying the risk estimates.

OMB also calculated that OSHA's formaldehyde rule would cost much more to reduce statistical cancer risks than other OSHA and Federal health standards. Some options being considered by OSHA would have a significant adverse economic impact on certain industries, including foundries, wood products and textiles, which were struggling to compete against imports. These disparities in risk and cost, and the potential impact of the regulation on affected industries and the jobs of workers in those sectors, raised questions about the reasonableness and economic feasibility of OSHA's proposed formaldehyde rule.

These comments did not "interfere" with the conclusions of OSHA scientists. They accepted, for example, OSHA's designation of formaldehyde as a potential carcinogen. Instead, OMB's filing raised for comment whether the magnitude of risk posed by formaldehyde exposures warranted Federal action, whether OSHA's analysis presented sufficient information to decision-makers to reach an informed decision, and whether OSHA should require the expenditure of significant private sector resources in the face of extreme uncertainty about the risk.

Such decisions are policy decisions that must be coordinated between Federal agencies to ensure that the nation's resources are being spent to mitigate the most serious risks and to avoid inconsistent and contradictory decisions among agencies. Staff scientists should not make these decisions; they should be made by policy officials who weigh all of the implications of Federal action, including uncertainty, economic impact and technical feasibility, and the significance of the health benefits to be realized. That explicit policy judgment is needed to translate scientific evidence into Federal action was also recognized by the Supreme Court in its 1980 decision to overturn an OSHA rule because OSHA had failed to show that the risk to workers was significant: "Factual determinations can at most define the risk in some statistical way . . . [the] determination that a particular level of risk is 'significant' will be based largely on policy considerations."

The major source of complaint about OMB "interference" with regard to the formaldehyde rule has been from OSHA staff scientists who state that they were overruled in their determination that the residual risk was "significant." While one may be sympathetic to their views on the subject, this decision is not a scientific conclusion arising from an experiment or research study, but a policy decision properly made by the head of OSHA and properly a subject of comment by OMB.

OMB's role in coordinating Federal policy between agencies was particularly important in the case of formaldehyde. At the time that OMB filed its comments in the public record, three other Federal agencies were considering the issue of whether the potential hazard posed by formaldehyde warranted Federal action, and if so, what action. The Consumer Product Safety Commission had attempted in 1982 to ban urea-formaldehyde foam insulation, but the U.S. Court of Appeals for the Fifth Circuit had overturned the ban because the court felt that the exposure data did not support the agency's conclusions about risk, despite the agency's "scientific" determinations that it did. The Department of Housing and Urban Development (HUD) had regulated formaldehyde emission levels in plywood and particleboard, but not certain kinds of fiberboard, and was considering the need for further regulatory action. The Environmental Protection Agency (EPA) was considering whether, under Section 4(f) of the Toxic Substances Control Act, formaldehyde posed "a significant risk of serious or widespread harm" to textile workers and consumers. Actions that EPA was considering included formally referring regulatory action to agencies such as OSHA and HUD or simply waiting for other agencies to decide if they needed to act. In addition, shortly after OSHA's publication of the NPRM, the National Cancer Institute completed the largest epidemiological study ever done on formaldehyde and concluded that there was "little evidence" that cancer mortality was associated with occupational exposures to formaldehyde. In such a dynamic and chaotic environment, it was particularly important that the Federal Government chart a stable and fully considered course.

OMB staff are well qualified to assess and discuss the general policy issues in health and safety regulation, as well as the reasonableness of an agency's decision. Many of the scientific conclusions reached in safety and health regulations involve general approaches of data handling and methodology that fall within the expertise of those trained in general data analysis, like the OMB analysts who assessed OSHA's formaldehyde rule. In fact, policy analysts are trained to compile, assess and present data, the weaknesses in the data, and the consequences of various options. Policy decisions should arise from this process, rather than from a wholly uncritical acceptance of the judgment of any participant in the regulatory process. As rules are developed, scientific judgments and conclusions are evaluated, along with input from lawyers, economists, statisticians, enforcers, administrators and, through the public record, the public, in the context of the overall policies adopted by the agency and the Federal Government, to reach a final decision.

The questions raised by OMB in the formaldehyde rulemaking, and in all reviews of Federal safety and health rules, pertain to issues of priority, approach and coordination of a coherent and balanced Federal policy on risk management for workers, consumers and the public. As we stated in the 1988 Regulatory Program of the United States Government: "Federal regulation cannot eliminate all safety, health and environmental risks. As a result, the regulation of each particular safety and health risk has to be kept in balance and proportionate with the regulation of all other such risks." (p. 8).

In conclusion, I feel strongly that the central review function currently being performed by this Office is essential to the development of a coherent, effective Federal policy on managing the health and safety risks faced by the American public. Such a policy should, as permitted by statute, be in balance with other societal interests, such as maintaining economic growth and jobs. In my testimony before the Committee, I listed several examples in which the central coordinating function of this Office resulted in regulations that were more effective, more efficient, and more likely to achieve the goals of the Congress and the Administration.

Sincerely,

Jay Plager

Jay Plager
Administrator
Office of Information and
Regulatory Affairs

Statement of

**MARSHALL J. BREGER**
Chairman
Administrative Conference of the United States

submitted to the
**Committee on Governmental Affairs**
**United States Senate**

on
Regulatory Reform: Federalism and the Regulatory Flexibility Act

September 14, 1988

## Introduction

Mr. Chairman and members of the committee, my name is Marshall Breger. I am Chairman of the Administrative Conference of the United States.

The Conference is privileged to have been asked by the committee to lend our perspective to the important issue you are considering today -- namely, the effect of federal regulation on small state or local governmental units. In evaluating my views, it is useful for you to understand the role of the Conference and the manner by which it reaches positions.

The Conference is an independent federal agency whose statutory mission is to perform studies of, and recommend improvements in, the administrative procedures used by federal departments and agencies. We try to assist the departments and agencies of the government in developing fair, effective and efficient procedures for the conduct of their responsibilities. To do so, we hire consultants, usually academic experts, to study procedural issues. Consultant reports are then reviewed by our professional staff and Conference committees made up of senior government officials and distinguished members of the private sector. In due course, these committees develop recommendations for presentation to our 101-member Assembly.

The Conference takes formal positions only through the vote of our total membership at plenary sessions, ordinarily held twice a year. It has not taken any positions with respect to implementation of the Regulatory Flexibility Act. As a consequence, I do not offer any formal position of the Conference on the issues you are reviewing. But over the years we have examined a range of matters that bear upon these issues. I am happy to share our experience with you.

## The Need for Special Treatment for Small Entities

An important part of our mission at the Conference is to recommend methods by which the federal government can improve the fairness of administrative processes. An essential element of fairness is the concept of "Equal Justice Under Law." According dissimilar treatment to those similarly situated is a classic case of discrimination and constitutes a fundamentally unfair approach to government regulation.

According similar treatment to dissimilar groups can at times result in a less visible but no less unfair form of government activity. By mandating uniform regulation, Congress and federal agencies, perhaps unwittingly, can favor large entities over smaller ones by placing proportionately heavier burdens on smaller members of the regulated sector.

Congress recognized the plight of small entities when it enacted the Regulatory Flexibility Act in 1980.[1] That legislation was intended to require federal agencies to pay greater attention to both the need for regulation of smaller entities and the ability of those entities to bear the costs of regulation.

The Act requires an agency to prepare a regulatory flexibility analysis (RFA) whenever it engages in notice and comment rulemaking. Basically, that analysis must describe the impact of the rule on small entities, including small governmental jurisdictions as defined in 5 USC 601(5) of the Act. The provisions of the Regulatory Flexibility Act first applied to regulations for which a notice of rulemaking was issued on or after January 1, 1981.

The Act contains two important exceptions. First, the requirement to prepare a regulatory flexibility analysis does not apply if the head of the agency certifies that the rule, if promulgated, will not have a significant economic impact on a substantial number of small entities.[2] Second, neither the agency's threshold determination not to apply the Act nor the adequacy of any RFA actually prepared is directly subject to judicial review.[3] The RFA is nevertheless part of the agency record[4] and the courts will look at the contents of an agency's analysis as part of their overall examination of whether an agency's ultimate decision is reasonable.[5] As the D.C. Circuit has held:

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[1] 5 U.S.C. 601-612.

[2] 5 U.S.C. 605(b).

[3] 5 U.S.C. 611.

[4] Ibid.

> [A] reviewing court should consider the regulatory flexibility analysis as part of its overall judgment whether a rule is reasonable and may, in an appropriate case, strike down a rule because of a defect in the flexibility analysis.[6]

Shortly after the Regulatory Flexibility Act was passed, the Conference asked one of its members, Paul Verkuil, a distinguished administrative law expert and, at the time, Dean of the Tulane Law School, to prepare a report on the Act. His report was presented in 1982 and remains an excellent analysis of the statute. It can be found in published form in the April 1982 edition of the Duke Law Journal.[7]

What is clear from Dean Verkuil's study is that the Regulatory Flexibility Act grew out of what he characterized as "a special solicitude for the problems of small business."[8] Although the statute embraced small governmental units, it did not focus on their needs. It is entirely appropriate that the Congress do so today.

Improving Regulatory Analysis

The Regulatory Flexibility Act essentially commands regulatory agencies to take seriously the special needs of small entities, and establishes procedural requirements for doing so. The Conference has not specifically examined agency implementation of the Act. That responsibility is carried out by the Office of Advocacy of the Small Business Administration. So we cannot say whether the existing set of incentives are sufficient to make agencies take serious account of the needs of small entities or whether statutory changes -- such as allowing direct judicial review of regulatory flexibility analysis issues -- are needed.

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[5] See, e.g., State of Michigan v. Thomas, 805 F 2d 176, 188 (6th Cir. 1986), citing Thompson v. Clark, 741 F 2d 401, 405 (D.C. Cir. 1984) and Small Refiner Lead Phase-Down Task Force v. EPA, 705 F 2d 506, 537 (D.C. Cir. 1983)

[6] Small Refiner Lead Phase-Down Task Force v. EPA, *supra*, 705 F 2d at 539

[7] Verkuil, A Critical Guide to the Regulatory Flexibility Act, [1982] Duke L.J. 213.

[8] Id. at 216.

But the Conference has looked generally at agency procedures for performing regulatory analysis of rules and issued recommendations on the subject in 1985.[9] I am pleased to include a copy of those recommendations as part of this statement. The recommendations were supported by an exhaustive study by Professor Thomas McGarity of the University of Texas Law School. A published version of Professor McGarity's study can be found in the June 1987 issue of the Texas Law Review.[10]

Although regulatory analysis, as required by Executive Order 12291, focuses primarily on the costs and benefits of agency rules generally, some of our findings are pertinent to regulatory flexibility analyses as well. First, and perhaps foremost, the Conference recommended that any regulatory analysis function be an integral part of the agency decisionmaking process from the earliest stage. The RFA should not simply be an add-on prepared by the agency's legal staff once the technical or policy analysts have completed their work. Rather, particularized treatment of small entities should be among the options considered as soon as the agency begins its information-gathering and other analytical efforts leading up to the promulgation of a proposed rule.

Equally important, agencies should consider whether their ordinary means of gaining information are likely to attract comment from small entities. If not, special procedures, such as local meetings or hearings, might be used. The Conference's recommendations in this regard are akin to the procedural requirements for notification and participation contained in section 609 of the Regulatory Flexibility Act.

Finally, the recommendation's treatment of the use of regulatory analysis to identify options, the inclusion of information in regulatory analysis documents, the retrospective assessment of previous analyses, and the use of consultants, all seem quite relevant to the regulatory flexibility analysis process.

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[9] Agency Procedures for Performing Regulatory Analysis of Rules (Recommendation 85-2), 1 CFR 305.85-2.

[10] McGarity, Regulatory Analysis and Regulatory Reform, 65 Tex. L. Rev. 1243 (1987). Originally published in 1985 ACUS Recommendations and Reports 107.

## Alternatives to Regulatory Analysis

Your staff has asked my Office, in our capacity as an institutional student of the administrative process, to explore the legal framework for options to the traditional rulemaking approach. I am happy to offer some observations in this regard.

Apart from the approach embodied in the Regulatory Flexibility Act -- i.e., the establishment of statutorily required procedures which tell agencies how to evaluate the special problems of small entities -- it seems to me that there are at least two alternatives that the Congress or agencies may legitimately pursue in an effort to take into account the special needs of small entities. First, Congress or agencies can simply exempt small entities, including small governmental jurisdictions, from the coverage of regulatory programs, in whole or in part. Second, the Congress and agencies can encourage efforts to achieve consensual compliance with federal regulation by actually according smaller entities a role in the drafting of proposed agency regulations..

### 1. Exemption for Small Entities

Section 603(c) of the Regulatory Flexibility Act directs agencies to consider whether they should exempt small entities from coverage of any proposed rule. But the Act itself does not confer any exemption authority. So exemption power must be found elsewhere.

Congress has, from time to time, expressly exempted small entities from an agency's regulatory reach. The National Labor Relations Act, for example, specifically excludes "any State or political subdivision thereof" from the definition of employers that are subject to NLRB jurisdiction.[11] Over several years Congress exempted certain farms which employ ten or fewer people from oversight by the Occupational Safety and Health Administration (OSHA) by attaching riders to the annual OSHA appropriations prohibiting that agency from using appropriated funds to administer regulations or standards applicable to such farms.[12]

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[11] 29 U.S.C. 152 (2)

[12] See, e.g., Departments of Labor, Health and Human Services, and Education and Related Agencies Appropriations Act, 1986, Pub. L. No. 99-178, 99 Stat. 1102, 1106 (1985).

Quite often, though, Congress gives an agency statutory authority to exempt entities from regulation when certain conditions are met. The National Labor Relations Act, for example, allows the NLRB to decline to assert jurisdiction over any labor dispute "where, in the opinion of the Board, the effect of such labor dispute on commerce is not sufficiently substantial to warrant the exercise of its jurisdiction."[13] The Board, from time to time, establishes dollar limits below which it will not exercise its regulatory jurisdiction over certain firms or types of institutions.[14]

The Interstate Commerce Commission has employed its exemption power specifically to exempt state and local governments which want to acquire a line of track that is being abandoned by a regulated railroad. Normally, the operations of such a line of track are under the regulatory supervision of the ICC. But a special provision of the Interstate Commerce Act, added by the Staggers Rail Act of 1980, allows the Commission to exempt certain rail transactions where regulation "is not necessary to carry out the [national] transportation policy . . . and . . . either (A) the transaction or service is of limited scope, or (B) the application of [the statute] is not needed to protect shippers from the abuse of market power."[15] In 1982, the Commission used its exemption authority to establish special rules to govern operations over an abandoned rail line which has been acquired by a State or other political subdivision. Basically, the Commission relieved the state or local entity of the regulatory burdens ordinarily associated with the start-up or termination of operations.[16] I am told that this exemption provision has been used on a number of occasions.

It is also worth noting that agencies in very limited circumstances may even create exemptions from their own jurisdiction in the absence of express statutory authority to do so. An excellent discussion of this power is contained in Judge Harold Leventhal's opinion in the case of Alabama Power Co. v. Costle.[17] To be sure, this power is extremely limited -- as it should be. Agencies, after all, are creatures of statute and their mission is to carry out the directives given them by Congress in those statutes, not to create exceptions to those directives. But as Judge Leventhal pointed out in approving exemptions for de minimis circumstances --

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[13] 29 U.S.C. 164(c)(1). **See generally NLRB v. Denver Building & Construction Trades Council et al.**, 341 U.S. 675, 684 (1951).

[14] See, e.g., 29 CFR Part 103 Subpart A (1987).

[15] 49 U.S.C. 10505

[16] 49 CFR 1150.21 (1987).

> Certain limited grounds for the creation of exemptions are inherent in the administrative process, and their unavailability under a statutory scheme should not be presumed, save in the face of the most unambiguous demonstration of congressional intent to foreclose them.[18]

Continuing sensitivity to the availability of exemptions from regulation when such exemptions are consistent with an agency's statutory mission would clearly advance the purposes embodied in the Regulatory Flexibility Act.

2. Consensual Approaches

If the Regulatory Flexibility Act is designed to encourage agencies, when drafting regulations, to take into account the special needs of small entities, I cannot think of a better way to do so than to bring those entities directly into the drafting process itself at an early stage. A prime vehicle for enhancing the role of small entities in the rulemaking process is negotiated rulemaking, also called regulatory negotiation or "reg-neg."

As the committee is well aware, the concept of negotiated rulemaking is quite simple. In ordinary rulemaking, an agency studies a problem largely through its own staff resources, although it may elicit assistance from the public as well. It reaches a tentative solution and publishes that solution as a proposed regulation. It then formally invites public comment. In due course, the agency issues a final rule in light of those comments. In negotiated rulemaking, by contrast, representatives of all affected interests, including the agency, come together in an effort to draft a proposed rule which specifically takes into acount the needs of the various interests, in conformity with the requirements of the governing statute. The drafting often takes on the quality of labor-management negotiations, with all the give-and-take that such negotiations entail. In the end, if the negotiators can reach consensus, a proposed rule is fashioned, which can be expected to receive the suppport of, or at least the acquiescence of, all interested parties. If less than total consensus is achieved, the process can still be valuable in identifying and narrowing issues and enabling the agency to understand the concerns and viewpoints of all parties. Following the negotiations, of course, the proposed rule can be published, and the public still has an opportunity to comment before the agency promulgates the final rule.

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[17] 636 F.2d 323, 357-61 (D.C. Cir. 1979).

[18] Id. at 357.

Nothing in the negotiation process relieves an agency from the requirements of the Regulatory Flexibility Act. Both the proposed and final rule must still contain the regulatory flexibility analysis or a certification of inapplicability. Moreover, nothing in the negotiation process precludes an individual small entity from presenting its views directly to the agency in response to any notice of proposed rulemaking eventually published for comment.

I believe the negotiated rulemaking process can serve the interests of smaller entities. "Reg-neg" begins with a convening process, in which all potentially affected interests, large and small, are identified, and representatives are selected to negotiate the proposed rule. In some cases, smaller entities, including governmental units, can aggregate their interests and participate through a common spokesman, thereby gaining an effective voice at the table that they might not have in a more conventional rulemaking.

Small governmental units have already been active participants in regulatory negotiations. Two Nevada counties, for example, participated through a common spokesman as part of the Nuclear Regulatory Commission's negotiated rulemaking regarding the submission of documents in the upcoming licensing proceeding concerning a geologic repository for disposal of high-level radioactive waste. The two counties concurred in the draft rule that was ultimately submitted to the NRC for adoption. The NRC is expected to act on the proposal shortly. Similarly, a representative of rural schools participated in an EPA negotiated rulemaking concerning the identification and control of asbestos-containing materials in school buildings.

Let me put in a small plug, at this point, for passage of S. 1504, the "Negotiated Rule Making Act of 1988." Fundamentally, S. 1504 sets up a framework for agencies throughout the government to establish rulemaking negotiating committees in accord with recommendations of the Conference and following the model used successfully by several agencies, including EPA and the NRC. The Conference was pleased to have testified in favor of the bill before this committee last May. The bill has been favorably reported out of committee and its enactment will provide an important impetus to agency use of negotiated rulemaking. I should note, in this regard, that S. 1504 authorizes appropriations of half a million dollars to the Conference to facilitate the start-up of negotiated rulemaking throughout the government. I could certainly imagine that small governmental entities, participating in a regulatory negotiation, could share in any funding available to facilitate this process.

## Conclusion

When Dean Verkuil examined the Regulatory Flexibility Act at the Conference's behest in 1982, he noted that the statute had the potential for producing workable compromises between government and the private sector without imposing undue burdens on the administrative process. It is useful to review whether those expectations have been realized insofar as small governmental units are concerned. If the committee believes that the Conference can play a helpful role in that review, we stand ready to undertake any study you may direct.

## RECOMMENDATION 85-2:
## AGENCY PROCEDURES FOR PERFORMING REGULATORY ANALYSIS OF RULES

Since 1974 executive branch agencies have been subject to a series of Presidential executive orders that required agencies to prepare comprehensive impact analyses for major rulemaking proposals. Variously termed "inflation impact statements," "regulatory analyses," and "regulatory impact analyses," these analyses were all designed to identify or measure the costs and benefits of rulemaking options being considered by Federal administrative agencies. Congress also has imposed impact analysis requirements on administrative agencies through the National Environmental Policy Act of 1969, the Regulatory Flexibility Act of 1980, and by amendments to authorizing statutes for particular agencies.

The regulatory analysis function has become increasingly formalized within agencies as a result of the proliferation and durability of these requirements. This Recommendation is based on a Conference study of the ways agencies have incorporated the regulatory analysis function into their decisionmaking process. A general conclusion from this study is that regulatory analysis can be a useful device in rulemaking if it is taken seriously by upper level agency decisionmakers; the regulatory analysis function is effectively integrated into the rulemaking process, and the limitations of regulatory analysis are recognized by those who rely upon it.

The Recommendation contains specific advice on the use and limits of regulatory analysis and on integration of regulatory analysis into the agency rulemaking process. Unless expressly so stated, the Recommendation is not intended to address application of the Freedom of Information Act to agency records used in regulatory analysis. In particular, it is not intended to expand or decrease the statutory protections afforded trade secrets and commercial or financial information obtained for use in regulatory analysis.

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

## RECOMMENDATION

### 1. The Use of Regulatory Analysis to Identify Options

Regulatory analysis[1] can be most useful to agency decisionmakers in identifying regulatory options if the regulatory analysis function is an integral part of the agency decisionmaking process. To make regulatory analysis a more effective device for identifying options, agencies should adopt the following practices:

a. When an agency begins intensive information-gathering and other analytical efforts on a rule, the agency's technical staff and regulatory analysts should attempt, at an early stage, to identify a broad range of regulatory options.

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[1] The following definitions are used in this recommendation:

"Regulatory analysis" is a comprehensive analysis of the economic, social, and environmental impacts of one or more alternatives for addressing a problem undertaken in connection with an agency rulemaking effort. A regulatory analysis may include or be separate from an environmental impact assessment of a rule prepared in compliance with the National Environmental Policy Act of 1969.

A "regulatory analysis document" is a written regulatory analysis, whether drafted to comply with Executive Order 12,291, the Regulatory Flexibility Act, or other statutes and executive orders. Regulatory analysis documents also may include similar documents which, though not required by statute or executive order, are prepared to comply with agency regulations or directives stating that the agency intends to treat the documents as regulatory analyses. The term "regulatory analysis document" is intended to include only final analyses prepared in connection with a proposed or a final rule.

A "regulatory analyst" is an agency employee who prepares the whole or part of a regulatory analysis. Regulatory analysts often are economists or policy analysts by training, and they often are assigned to a separate institutional unit within an agency.

The "technical staff" is composed of agency employees within a program office who conduct investigations, prepare technical support documents, and often draft preambles and recommended language for proposed and final agency rules. When a member of the technical staff is assigned to perform a regulatory analysis, he or she then is both a regulatory analyst and a member of the technical staff.

b. Agencies should experiment with a phased system of reducing options. Under a phased system, the agency initially should identify as large a number of options as it can for brief study. As options are considered and rejected, the remaining options should be analyzed with increasing thoroughness. As resource constraints preclude further consideration of an option, the agency should list the option in its regulatory analysis document and explain briefly why the option did not warrant further study.

c. Although the extent to which options are identified and analyzed in regulatory analysis documents is largely a matter for individual agency management, regulatory analysis documents normally should attempt to identify and analyze several realistic regulatory options.

2. Integrating Regulatory Analysis into the Decisionmaking Process

a. Timing of Analytical Input. If regulatory analysis is to be used in a rulemaking, the agency decisionmaking process should be structured to involve agency regulatory analysts early in the evolution of the rule, before alternatives have been eliminated. Regulatory analysis should not be used to produce post hoc rationalizations for decisions already made, nor should it be allowed to unduly delay rulemaking proceedings.

b. Communicating Policy to Regulatory Analysts. Regulatory analysis can be a valuable tool for communicating policy within regulatory agencies because a primary function of regulatory analysis is to measure regulatory options against agency policy goals. Upper level policymakers in agencies should provide clear guidance to subordinate decisionmaking units (such as steering committees and working groups) on the policies that should guide the agency in choosing among options in individual rulemaking proceedings.

c. High Level Involvement at Important Decisionmaking Junctures. Because of the different perspectives of an agency's regulatory analysts and its technical staff, disagreements over appropriate agency policy will often result when both staffs are relied upon in the decisionmaking process. The agency should adopt procedures that will encourage resolution of such disagreements at important decisionmaking junctures at a high policy level.

d. Regulatory Analyst's Role in Responding to Comments. When an agency solicits public comment on a regulatory analysis document or on provisions of a proposed rule that are supported by the regulatory analysis document, the agency should structure its decisionmaking process to ensure that the agency's regulatory analysts participate in developing the agency's response to the public comments.

e. Intragovernmental Comments. Agencies should place in the public file of the rulemaking proceeding any material factual information (as distinct from indications of governmental policy) from other agencies that is directed to the contents of regulatory analysis documents. See ACUS Recommendation 80-6 (1 CFR §305.80-6).

f. Public Availability of Regulatory Analysis Documents. Agencies should make regulatory analysis documents available to the public when they publish proposed and final rules in the Federal Register, even if the Freedom of Information Act's exemption for intra-agency memoranda, 5 U.S.C. §552(b)(5), might apply to portions of the documents. As appropriate, agencies also should prepare brief summaries of regulatory analysis documents and make them available to the public and appropriate congressional committees. The summaries should contain tables, charts, and other devices, as needed, to make the information contained in the regulatory analysis documents understandable.

3. Use of Regulatory Analysis Where Not Required or Where Options Are Foreclosed

a. Regulatory analysis documents should identify the costs and benefits of reasonable options, even if the agency may lack the statutory authority to implement some of the options. If the agency determines that the best options cannot be implemented under its statutory authority, the agency should so inform the institutions with power to implement them, such as Congress and other agencies.

b. Agencies should consider using regulatory analysis when undertaking significant rulemaking proceedings with projected impacts falling below the established thresholds for requiring formal regulatory analyses.

### 4. Information in Regulatory Analysis Documents

This part of the Recommendation addresses the information that should be included in regulatory analysis documents for use by the public and agency decisionmakers.[2]

a. When agencies use quantitative models to quantify important variables in regulatory analysis documents, the known limitations of those models should be clearly stated.

b. To prevent quantitative models from oversimplifying complex decisionmaking factors, agencies should require regulatory analysis documents to (1) state clearly the major assumptions that undergird the models relied upon in the regulatory analysis, and (2) describe important decisionmaking variables that are not subject to quantitative analysis.

c. Agencies should require that regulatory analysis documents attempt to characterize the uncertainties that are included in quantitative predictions by using tools such as confidence intervals, multiple assessment models, sensitivity analysis, and worst case analysis.

d. Agencies should require that regulatory analysis documents address explicitly the distributional impacts of rulemaking options and the methods used for discounting future costs and benefits. Agencies should consider using more than one discount rate to clarify the sensitivity of the analytical projections to the discount rate.

e. Agency regulatory analysis documents should make explicit reference to any agency policies that motivate the agency to choose one set of assumptions over another, draw one inference rather than another, or choose one quantitative model over another.

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[2] The Conference has previously recommended that agencies using cost-benefit and similar analyses include in notices of particular proceedings certain information about the analytical methods and assumptions used in conducting the analyses. See ACUS Recommendation 79-4 (1 CFR §305.79-4).

## 5. Informational Needs for Regulatory Analysis

a. Agency Access to Information. Adequate information on the costs and economic impacts of proposed rules is essential to the regulatory process, and often the most important source of this information is a regulated party. Therefore, in exercising its authority under the Paperwork Reduction Act, the Office of Management and Budget should allow agencies to address reasonable requests for cost and economic impact information to regulated parties when the information is needed for regulatory analysis. The Office of Management and Budget should continue to coordinate its regulatory analysis review function with its paperwork reduction function to ensure that it approves information-gathering activities that are designed to yield information that it is likely to require later in the rulemaking review process.

b. Coordination of Information Gathering Activities. Agencies should coordinate their sponsored research activities with their regulatory analysis initiatives. More specifically, agencies should include regulatory analysts in their process for setting long-term research priorities. In addition, agencies should encourage the participation of representatives from the office responsible for agency-sponsored research in the rulemaking process at the very early stages when informational needs are defined.

c. Cooperative Regulatory Analysis. Agencies should consider whether the techniques suggested for negotiation of proposed regulations in ACUS Recommendation 82-4 (1 CFR §305.82-4) might be useful in undertaking, in specific proceedings, "cooperative regulatory analysis." This would consist of bringing representatives of all affected parties together, consistent with the Federal Advisory Committee Act where applicable, to assess the validity of particular studies prior to relying upon those studies in regulatory analysis documents.

d. Reducing Potential Bias. Agencies should attempt to reduce the impact of bias in the sources of the information that they use in preparing regulatory analysis documents. Though agencies should consider the source of information in giving it weight, this does not mean that they should automatically attach less value to information simply because it comes from a source with an interest in the outcome of the rulemaking. Agencies should reduce the impact of bias by:

(i) consulting, whenever possible, multiple sources of information in preparing regulatory analysis documents;

(ii) carefully citing in regulatory analysis documents all information upon which the analysis draws, and making the information available for public scrutiny at convenient times and places;

(iii) actively soliciting comment and criticism from acknowledged experts in the fields that the documents address.

e. Retrospective Assessments of Previous Analyses. Agencies should regularly perform retrospective assessments of the predictions made previously in regulatory analysis documents. Retrospective analysis can provide information on the accuracy of past agency predictions and thereby enable an agency to increase the accuracy of future predictions or make judgments about the value of regulatory analysis to its regulatory effort.

## 6. Use of Consultants in Preparing Regulatory Analysis Documents

Agencies can benefit from entering into consulting contracts with qualified experts to aid in gathering and analyzing information for regulatory analysis documents. However, agency personnel should retain the ultimate responsibility for the contents of regulatory analysis documents and guard against consultant conflict of interest. To these ends, agencies should ensure that: (1) agency employees, not consultants, draft regulatory analysis documents, and (2) when a regulatory analysis document relies upon consultant reports, the reports are placed in the public file of the rulemaking proceeding, even if the Freedom of Information Act's exemption for intra-agency memoranda, 5 U.S.C. §552(b)(5), might apply to portions of the reports.

## 7. The Scope and Limits of Regulatory Analysis

a. Cost-benefit analysis is an effective tool for marshalling and analyzing information and for establishing regulatory priorities.

b. Other analytical techniques, such as cost-effectiveness analysis and multi-objective analysis, are also useful for rulemaking that involves health, environmental, historical, artistic, and aesthetic considerations for which markets do not exist.

c. Agency rulemaking decisions must take into account the limits of the agency's statutory authority and its overall policy goals, as well as the limits of the methods and data used in the regulatory analysis.

d. The same criteria should be used in granting exemptions from regulatory analysis requirements, irrespective of whether the proceeding has been commenced to formulate new rules or to amend or repeal existing rules.

88-20

# STATEMENT OF MARGARET SEMINARIO, ASSOCIATE DIRECTOR DEPARTMENT OF OCCUPATIONAL SAFETY HEALTH, AND SOCIAL SECURITY AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS SUBMITTED TO THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS ON S.1504, NEGOTIATED RULEMAKING ACT

**MAY 13, 1988**

The AFL-CIO is pleased to comment on S.1504, the Negotiated Rulemaking Act, legislation that would encourage the use of negotiated rulemaking as an alternative to current rulemaking procedures.

Our comments on the subject of negotiated rulemaking and the proposed legislation are based upon years of experience with agency rulemakings, particularly on worker safety and health standards, and AFL-CIO and union participation in several OSHA and EPA negotiated rulemakings.

The AFL-CIO believes that the goal of regulatory programs should be to promulgate effective standards in a timely fashion. When judged against this guidepost, the record of agencies like OSHA and EPA has been less than desired. Through traditional rulemaking procedures, OSHA has set important standards on hazards like lead, cotton dust and asbestos. However, over the years, due to increased litigation and requirements under executive orders, the rulemaking process, always a significant undertaking, has become lengthy and complex. In recent years, as a result of government deregulatory policies and interference by the Office of Management and Budget, the regulatory process has been further impeded.

Negotiated rulemaking has been proposed as an alternative to the current rulemaking process. By developing proposed regulations through direct discussions by major interested parties, it is hoped that better regulations can be developed in a more timely fashion without litigation on final rules.

To date the AFL-CIO or our affiliated unions have participated in negotiated rulemakings on four standards: OSHA standards on benzene and methylene dianiline (MDA) and EPA rules on asbestos abatement in schools and farmworker protection. The unions experience with these rulemakings has been mixed. Mediated rulemakings on benzene and farmworker protections failed to produce agreements. Discussions on MDA produced a proposed standard agreed to by all parties, but after a year, OSHA has yet to issue a proposal. The EPA negotiation on the asbestos abatement rule produced an agreement on some matters and a final standard was issued. However, major issues such as when to require asbestos abatement were unresolved and despite agreement on many items the industry still filed a legal challenge to the final standard.

In the AFL-CIO's experience, the negotiated rulemaking process does allow for a more open and direct exchange of views and positions than the traditional rulemaking process. If the process works, the overall rulemaking process can be expedited. However, there are aspects of the negotiation process which are problematic.

Participation in negotiated rulemaking requires a substantial commitment of time. Industry typically can devote more people and resources to the rulemaking than labor or public interest organizations and, therefore, tends to dominate the process. The standards best suited to mediation are those for which the number of interest parties and controversy are limited. Standards fitting this characterization, however, may not be the highest priority. Interested parties, therefore, may not be willing to devote the time necessary for a negotiated rulemaking on the subject.

In a traditional rulemaking, the government agency develops a proposed rule based upon scientific evidence and other information available from the literature or solicited from the public. The rulemaking record is further developed by written comments and testimony during public hearings. This record evidence forms the basis for agency discussions and final standard.

In a negotiated rulemaking, scientific evidence and information is not always available to the interested parties and process, rather than substance and evidence, tends to govern the outcome. This problem can be further exacerbated by an overzealous mediator whose goal may be to have the process work regardless of the content of the negotiated standard.

Given our experience with negotiated rulemaking to date, the AFL-CIO does not believe this alternative approach has widescale application, but rather can be used effectively in selected situations. To determine whether to participate in negotiated rulemaking there are a number of conditions which the AFL-CIO believe should be met:

1. The regulations must be of significant importance to warrant participation in the process and there must be a reasonable likelihood that negotiations will succeed;

2. The agency must commit itself to issuing proposed and final rules within prescribed time frames, whether or not negotiations succeed;

3. The industry must be committed to work towards the development of a proposed rule;

4. All parties must agree to provide evidence and information needed for decisionmaking;

5. The agency must devote staff and resources necessary to conduct the proceedings, including payment of travel expenses for parties who could otherwise not participate;

6. The Office of Management and Budget must agree not to block any proposal developed; and,

7. The agency must agree to issue the negotiated proposal, or if not, provide reasons why the negotiated standard was not proposed and solicit comments from the public.

Turning to the proposed legislation S.1504, the bill would establish a framework for negotiated rulemakings and promote the use of this procedure as an alternative to the current process.

The AFL-CIO believes that the framework established for negotiated rulemaking under the bill, through formal advisory committees with full participation by interested parties, is a sound approach. We believe that this framework would be further strengthened by provisions which would require agencies to establish deadlines for regulatory action and which would assure that scientific evidence and other information is made available to rulemaking committees.

The AFL-CIO has concerns regarding those aspects of the bill which promote widescale use of negotiated rulemaking. In our view negotiated rulemaking may be successfully applied on a selective basis. The use of this alternative method, however, is still in the experimental stage and an endorsement for broad use as embodied in S.1504 is premature.

The Federation shares the Committee's goal--to improve the regulations and the regulatory process. We believe that a renewed government commitment rather than the adoption of alternate procedures is the key to achieving that goal.

**The Conflict Clinic, Inc.**

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## COMMENTS ON S-1504

## THE NEGOTIATED RULE MAKING ACT OF 1987

## PREPARED FOR HEARINGS OF SENATE GOVERNMENT AFFAIRS COMMITTEE

MAY 13, 1988

The Conflict Clinic, Inc. thanks Senators Levin and Glenn for their attention to the processes of government and thank the Senate Government Affairs Committee for the opportunity to submit comments on S-1504.

The Conflict Clinic, Inc. is a non-profit conflict resolution group affiliated with the Center for Conflict Analysis and Resolution at George Mason University in Fairfax, Virginia. The Clinic focuses its resources on the study and resolution of complex public disputes.

The Conflict Clinic wishes to go on record as strongly supporting this legislation. Collaborative public processes have evolved in the last five years to the degree that they are efficient and effective tools to prospectively involve parties of interest who otherwise would challenge the implementation of rules and regulations intended to carry out public policy.

The Clinic wishes to register four broad comments on areas of the legislation which be believe might be strengthened by small changes.

1) Qualifications of convenors and mediators in negotiated regulatory proceedings: Skills required to conduct this role are not spelled out in the Bill, which provides, generally, that the agency should nominate a person without conflicts of financial interest in the matter and that the major parties should agree to that nomination. We believe that convening or mediating complex public disputes requires skills slightly different from those needed to handle private disputes.

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Resolution at
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Even experience in complex commercial or labor-management controversies cannot completely prepare a mediator for the peculiar needs of a public dispute. In these public disputes, we have found special attention is required to issues of representation, the role of the media, the value of shared data, and the role of expertise.

2) Evaluation of Regulatory Negotiation: Many claims have been made and will be made about the virtues of negotiated rule-making. The Conflict Clinic believes that there are benefits, but suggests that in recognition of the innovative nature of this Bill, that agencies using these procedures be encouraged by specific language in the bill to monitor the proceedings which occur under its provisions during the first five years of its effect to document and thereby determine:

a) Do negotiated rules emerge more quickly and cheaply?

b) Is it possible to identify prospectively all (or even the majority) of interests affected by a proposed rule?

c) Does the use of negotiated rule-making reduce measurably the litigation or other obstructive actions of parties resistant to regulation of the issue?

d) Are the results achieved by the varying facilitative styles and by different mediators distinguishable? If so, what lessons can be learned to enhance the overall practice in this field?

3) Training of advocates to participate: Negotiated rule making, like participation in any other public process requires particular skills. Persons and groups training in adversarial skills cannot be expected to instantly adapt to this new environment. Agencies using these procedures should be encouraged by specific language in the Bill to offer potential participants orientation or training in the process they are invited to join, or should refer potential participants to such programs.

4) Implications of adoption of these procedures in Federal rule making. The use of these processes will be felt at every level of public life. Agencies using these processes should be encouraged to consider the application of comparable processes to development of procedures for other phases of administration, including development of intermodal implementation plans and in enforcement.

The Conflict Clinic, Inc. would be happy to comment further at the request of this Committee. Again, we thank the Committee for this opprtunity to submit comments.

-- Comments prepared by Frank Blechman
Associate
The Conflict Clinic, Inc.

The Conservation Foundation

April 22, 1988

The Honorable John Glenn
Chairman
Governmental Affairs Committee

The Honorable Carl Levin
Chairman
Oversight of Government Management Subcommittee
Room 340
Dirksen Senate Office Building
Washington DC 20510
Attn: Harry G. Broadman

Dear Senators Glenn and Levin:

The Conservation Foundation appreciates being given this opportunity to submit written comments on S.1504, "The Negotiated Rule Making Act."

The Conservation Foundation, a not-for-profit organization under 501(c)(3) of the Internal Revenue Code, has been a leader since the mid-1970s in evaluating and promoting, where appropriate, the development and use of negotiation and other consensus-based approaches in public decision making. I serve as the Director of the Foundation's Program on Environmental Dispute Resolution, through which The Conservation Foundation 1) provides mediation services for federal and state negotiated rule making efforts, 2) conducts research about the effective use of negotiation and mediation in public decision making, and 3) provides technical assistance and educational programs to share information about what we and others have learned in this field.

The Conservation Foundation, established in 1948, entered the field of environmental dispute resolution because of its unique history and competence in dealing with complex, environmental issues in a reasoned and balanced way; because of the credibility the Foundation enjoys with a wide spectrum of opinion leaders; and because of the experience, skills, and reputation it has developed as a convenor and mediator of policy negotiations. The Foundation's activities in this area grew considerably after its merger with RESOLVE in 1981.

Specific to the issues in S.1504, The Conservation Foundation has provided mediation services in five negotiated rulemaking efforts at the U.S. Environmental Protection Agency, the Federal Trade Commission, and the Nuclear Regulatory

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*Affiliated with World Wildlife Fund*

Commission. In addition, I recently completed a three-year term on the Board of Directors of the Society of Professionals in Dispute Resolution, and I currently serve on the Society's Commission on Qualifiations and as President of its Washington DC chapter.

## Comments on S.1504

### Purpose

Overall, we wish to express strong support for the purposes and provisions of S.1504. We particularly endorse the fact that the Act "...will establish a framework for the conduct of negotiated rule making..." (Section 2(6)).

Under the appropriate circumstances, adding a negotiation step prior to publication of a Notice of Proposed Rule Making can improve the quality of the proposed rule and can reduce subsequent controversy and delay. Although we do not view traditional rule making as having quite as negative characteristics as suggested in the findings, we do think that Congressional authorization to agencies to "supplement and enhance the rule making procedures under the Administrative Procedures Act, where appropriate, by establishing a negotiated rule making committee..." (Section 3) would be a very positive action.

One modification to Section 3 of S.1504 would be helpful, however. For numerous reasons, it is important to preserve the public notice and comment provisions of the APA. Thus, we would encourage substitution of the words "...that rule's development" at the end of Section 3 by the following: "...a consensus on a proposed rule to be used as the basis for the rule proposed by the agency for notice and comment." We assume that this is consistent with the intention of S.1504, given the language in Section 5(a)(7).

### Definitions

One of the factors that contributes to the success of negotiated rule making (and other negotiation processes) is the acceptability to the parties of the terms under which the negotiation is conducted. To achieve this, it is crucial that the convenor and mediator be acceptable to all parties as impartial with respect to their interests. Thus, we recommend that the word "impartial" be inserted in the definition for convenor (Section 4(7)) and that the definition for mediator read: "The term 'mediator' means an impartial person, acceptable to the parties to the negotiation, who aids in the discussions and negotiations ..." (Section 4(9).

## Publication of Notice

We strongly support the provisions in Section 6(a) because it increases the likelihood both of ensuring that all interests are adequately represented and of consensus concerning the terms under which the negotiation is convened.

We suggest a minor change in Section 6(b)(2). Given the definition of "interests" in Section 4 as multiple parties which have a similar point of view or which are likely to be affected in a similar manner, few applicants will be able to provide evidence of authorization to represent an entire interest. (Also, those identified by the convenor are not required to provide such evidence.) The word "interest" should be replaced by "organization" or "party." Section 6(b)(3) provides an alternate way of avoiding redundancy in representation of "interests."

## Consideration of Proposals and Conduct of Negotiations

We support the provisions in Section 7 with two suggested modifications.

First, although we generally support Section 7(c), we would propose that, where mediators from the Federal Government are nominated, they not be employed by the agency that is responsible for promulgating the rule or that is a party to the negotiation for other reasons. It is our experience that the other parties do not perceive any individual employed by these agency as truly impartial, although they may not feel comfortable objecting. To accomplish our suggestion, Section 7(c) could be rewritten as follows: "Notwithstanding section 10(e) of the Federal Advisory Committee Act, an agency may nominate either a person from the Federal Government, other than from any agency that is represented in the negotiations, or a person from outside the Federal Government to mediate the negotiations of the committee, subject to the approval by consensus of the negotiated rule making committee. ..."

Second,in Section 7(g), it has been our experience in negotiations in which parties do not reach a consensus that committee members also do not agree on how to characterize the areas of disagreement. It is inappropriate for mediators to substitute their characterization of the areas of disagreement, in part because this characterization is so subjective and, thus, the mediator would be seen as siding with one side or another. Therefore, we strongly urge that the final sentence in this section delete that requirement and read instead: "If the negotiated rule making committee does not reach a consensus on a proposed rule, the report shall so state and shall include such recommendations and background materials as the negotiated rule making committee considers appropriate."

### Termination of Committees

Section 9(a) seems to add a helpful option to the general practice of negotiated rule making to date, in that it encourages the negotiating committee to remain in existence during the notice and comment period, thus creating at least the opportunity for the committee as a whole to reconsider its recommendations in light of public comment. Obviously, this should not be used to minimize the agency's final authority to promulgate the final rule, however.

### Compliance with Federal Advisory Committee Act

As mentioned above in the context of Section 5(a) and consistent with FACA, it is important that negotiated rule making committees include a balanced representation of the interests affected by the proposed rule. The costs of effective representation are often considerable. Public interest groups, however, generally do not have the financial or personnel resources to bear these costs. Such costs include, but often go far beyond the expenses of travel and accommodations to attend meetings. Many regulations involve considerable technical complexity which all parties must analyze and, sometimes, rebut. Regardless of the technical complexity of the regulation, however, for parties to negotiate effectively in their interests requires considerable time and resources in preparing proposals, formulating options, assembling arguments, and evaluating the proposals of others.

Thus, we strongly urge that Section 11(c) be rewritten as follows: "...except that an agency shall, pursuant to section 7(d) of the Federal Advisory Committee Act, pay reasonable travel and per diem expenses, reasonable compensation, and reasonable assistance in procuring technical assistance, to persons affected by the rule...." (Note: If the Administrative Conference establishes a resource pool for the participation of public interest groups, as suggested below, the requirement that agencies do so could be modified to apply only to those circumstances in which the ACUS resource pool does not cover all reasonable costs of participation.)

### Role of the Adminstrative Conference of the United States

The 1982 recommendation by the Administrative Conference of the United States to encourage negotiated rule making was a milestone in the development of this option for developing a consensus on the basis of a proposed rule. Authorizing the role and funds for ACUS to support the broader implementation of these recommendations, particularly in agencies that have little experience with negotiated rule making, is a generally positive step.

It also is important to note, however, that private mediation organizations (such as The Conservation Foundation, ERM-New England, and The Mediation Institute), individuals (such as Philip J. Harter, attorney at law), and the Federal Mediation and Conciliation Services have convened and mediated virtually all of the negotiated rulemaking efforts to date. In addition, the agencies that have convened negotiated rulemaking efforts and the parties to these negotiations themselves have gained valuable perspectives on the process. Thus, much of the expertise required to advise federal agencies and/or to perform other functions supporting negotiated rule making occurs in the private sector, as well as in public agencies such as ACUS, FMCS, and the agencies that have used negotiated rule making to date. In addition, the Community Relations Service in the U.S. Department of Justices and professional associatiations, such as the Society of Professionals in Dispute Resolution, have considerable expertise relevant to this process.

Thus, we would suggest that Section 12(a) be modified as follows: "An agency is encouraged to consult with the Administrative Conference of the United States, other public or private organizations and individuals, and/or professional organizations, for information and administrative assistance in forming a negotiated rule making committee and for information and assistance relating to negotiation and mediation processes.

Similarly, we recommend that language be added to Section 12(b) so that ACUS could benefit from the experience of the private sector in establishing rosters. A simple addition could be made as follows: "The Administrative Conference of the United States, in consultation with the Federal Mediation and Conciliation Service and other public and private entities with experience in negotiated rule making, shall maintain a roster...." We, also would like to underscore the importance of the last sentence in Section 12(b), both so that agencies retain the flexibility to draw from the existing depth and variety of experience that currently resides in the private sector as well as the public sector and so that unintentional and unproductive constraints on the private sector are avoided.

Sections 12(d) and 14 are an important part of accomplishing the intent of Section 12(a). However, given that the level of funding authorized annually in Section 14 is not much less than the total cost of all 14 negotiated rule making efforts to date, given the importance of financial support for adequate public interest group representation, and given the fact that compiling and maintaining data is the only service that ACUS is required to provide by S.1504 with the funds authorized in Section 14, we recommend that Section 12(f) be rewritten as follows:

The Adminstrative Conference of the United States, in consultation with agencies utilizing the roles described for ACUS in Sections 12(a-e), mediators with experience in negotiated rule making, and public interest organizations, shall create a fund to pay all or part of the expenses of certain members determined to be eligible for assistance in accordance with section 11(b). In addition, the Administrative Conference of the United States is encouraged to pay, upon the request of an agency head, all or part of the expenses of convening and conducting a negotiated rule making proceeding. Such expenses may include, but are not limited to, all or part of the costs of convenors and mediators, administrative costs, and training costs." Congress also may want the annual report specified in Section 12(d) to include information on how the appropriated funds have been spent in accomplishing the purposes of this Act.

Again, thank you very much for the opportunity to comment on this proposed legislation. I hope these comments have been helpful and that you will contact the Foundation if you have any questions.

Sincerely,

Gail Bingham
Director, Program on
Environmental Dispute Resolution

John T. Dunlop
Lamont University Professor, Emeritus
Harvard University

## Negotiated Rule Making, Testimony on S. 1504

## Before the United States Senate Committee on Governmental Affairs

Mr. Chairman and members of the Committee, I am pleased to be invited to testify on S. 1504 designed "to facilitate the formation of negotiated rule making committees."

1. Background. I became directly involved in helping to develop what has come to be called "negotiated rule making" when faced with the problems of controlling prices and wages and then phasing out controls in Phases III and IV of the stabilization program in 1973-74 as Director of the Cost of Living Council. The complexity of regulations in the rapidly changing economic environment of that period as well as the uncertainty of responses of business and labor led me to negotiate with the individual companies and parties over performance with imposition or removal of controls.[1] Regulations in lumber, cement and fertilizer illustrated this approach. The method comes naturally to one experienced in labor-management negotiations and mediation.

The Labor Department, to which I moved as Secretary in 1975-76, had administered 18 regulatory programs in 1940. By 1960 the number had expanded to 40, and in 1975 the number stood at 134 including such complex legislation as the Employee Retirement Income Security Act of 1974 (ERISA) and the Occupational Safety and Health Act of 1970 (OSHA). The Labor Department had become a major regulatory agency, far from its traditional role. I mediated, published for comment, and then issued regulations relating to section 13(c) of the Urban Mass Transportation Act under which subsidy funds were withheld until the Secretary of Labor certified that employees would not be adversely affected by the federally funded activities. I also sought to mediate an OSHA standard for coke oven emissions. I also presented a major paper, "The Limits of Legal Compulsion,"[2] to all Labor Department policy officials and to others in the Ford Administration to stress the need for such changes in the regulatory process.[3]

Brief mention may be made of the negotiated regulations developed in the late 1970's under the Pay Advisory Committee appointed by President Carter which I chaired.[4]

Since the mid-1970's many others--including Richard B. Stewart, Henry H. Perritt, Jr. and Philip J. Harter--have contributed to the growing literature, experience and have perfected the methods of negotiated rule making, most notably recently with the support of the Administrative Law Conference of the United States.

2. Three categories of disputes. There are three categories of disputes in governmental processes which may utilize alternative means of dispute

resolution from those traditionally established. The first category is disputes in the course of legislative enactment that utilize steps outside the regular legislative process. The 1926 Railway Labor Act was developed by railway executives and union officials and enacted by Congress without amendment of any consequence.[5] The Social Security Amendments of 1983 were developed by a National Commission headed by Alan Greenspan that included representatives of business and labor and key members of both Houses of Congress from both parties.[6] A number of states have often used this method to resolve disputes over legislation.[7] The second category is disputes relative to executive regulations implementing legislation that use steps outside the traditional administrative process. The subject of these hearings concerns such disputes and procedures for their resolution. The third category relates to disputes in the application of regulations or rules to particular cases that utilize non-traditional methods of dispute resolution. In all three of these areas there have been considerable advances in new means to reach consensus or settle disputes in the past decade. This larger setting for negotiated rule making (second category) helps to place the present legislative interest in a larger developing context.[8]

3. Potentials of Negotiated Rule Making.

(a) A more comprehensive and acceptable data base may be developed under negotiated rule making compared to the ordinary procedures of the administrative procedures act which largely places on the government the responsibility for factual studies. Parties that introduce partisan studies and data sources do not contribute to an agreed upon data base for common discourse and decision. Interest groups involved in regulatory decisions often have data sources and perspectives that contribute significantly to a more comprehensive view of facts and issues. My experience teaches me that the first essential to consensus is an agreed upon statement of the factual or data base.[9] A determination of facts by professional experts will not alone contribute much to acceptance unless the factual base can be agreed. Negotiated rule making contributes to this foundation in a superior way compared to the procedures of the administrative procedures act.

(b) Negotiated rule making has the potential to achieve regulations that are superior to the interested parties and in the public interest. The adversarial procedures of the administrative procedures act often hide the "true" or "common" or "most efficient" position of parties as they argue for extreme positions to protect their interest. Government officials may never know what they would reasonably accept or regard as most appropriate. In negotiated rule making various parties are more likely to trade information and reach a mutually acceptable position. The government officials, of course, still need to determine whether that position, or some modification, is in accordance with the "legislative standards" or "in the public interest". But a superior position is a potential.

(c) The negotiated rule making process has the potential materially to reduce litigation in the period of establishing standards and in enforcement compared to the normal processes of the administrative procedures act. Such a result reduces delay and costs of enforcement. When parties have been involved in the development of regulations and implementation of legislation, they are generally less likely to fight issues through administrative tribunals and the courts, at great expense in time and money. They are more likely to seek to work issues out with contesting parties and with the administrative agency.

(d) I believe that OMB has interfered far too frequently in the development of regulations in recent years under Executive Orders 12291 and 12498 after discussions in the departments and agencies.[10] Negotiated rule making will constrict OMB as a practical matter.

4. Several Cautions.

(a) One must be careful to recognize that negotiated rule making may not be appropriate or may not succeed with each and every regulation that is required to be promulgated. There may be so diffuse a group of interests or interests so difficult to identify that negotiations among parties may not be practical. There may be such diversity or inequality among parties as to preclude a practical forum[11] in which to consider possible regulations. But there are numerous regulations that would benefit from the negotiated rule making technique.

(b) It is essential to emphasize that negotiations are not a substitute for the formal processes of publishing for comment and for review by the responsible official followed by publication of regulations with the right to challenge in the usual way. Negotiated rule making does not constitute a diminution of governmental responsiblity; it is not the exploration of the privatization of government functions.

5. Comments on S. 1504

(a) In Section 8, I would want to add a reference to the function of any committee designed to negotiate a regulation or rule to develop the appropriate factual base for discussion and consensus. Gathering, discussing, interpreting data and underlying concepts is an essential first step in my experience to reaching consensus or agreement.

(b) I am not entirely in agreement with the view that a regular official of an agency should be precluded from exercising the role of "convenor", although limits of time and complexity may often warrant the selection of an outsider.

(c) I am supportive of the role assigned to the Administrative Law Conference (Section 12) to encourage the development of negotiated rule-making.

John T. Dunlop

## Notes

1. See, John T. Dunlop and Kenneth J. Fedor, The Lessons of Wage and Price Controls - The Food Sector, Cambridge, Mass., Harvard University Press, 1977, pp. 233-60, particularly p. 242; Hearings Before the Subcommittee on Production and Stabilization of the Committee on Banking, Housing and Urban Affairs, United States Senate, 93 Cong., 2d Sess, February 6, 1974, pp. 413-667, particularly p. 455, 487.

2. John T. Dunlop, "The Limits of Legal Compulsion," Labor Law Journal, February 1976, pp. 67-74.

3. For an elaboration of the historical development of negotiated rule making, see, Henry H. Perritt, Jr., "Administrative Dispute Resolution: The Development of Negotiated Rulemaking and Other Processes," Pepperdine Law Review, Vol. 14, No. 4, 1987, pp. 867-75; Henry H. Perritt, Jr., "Negotiated Rulemaking Before Federal Agencies: Evaluation of Recommendations by the Administrative Law Conference of the United States," The Georgetown Law Journal, August 1986, pp. 1627-1717. Also see, Administrative Law Conference of the United States, Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution (Washington, D.C., 1987).

4. Final Report on the Anti-Inflation Guidelines by the Pay Advisory Committee 1979-80, A Study Prepared for the Use of the Joint Economic Committee, Congress of the United States, Washington, D.C., 1982.

5. Harry A. Millis and Royal E. Montgomery, Organized Labor, New York, McGraw-Hill Book Company, Inc., 1945, p. 737.

6. "Report of the National Commission on Social Security Reform," Social Security Bulletin (February 1983), pp. 3-38; "Social Security Amendments of 1983: Legislative History," Social Security Bulletin (July 1983), pp. 3-48.

7. I have served as Chair of various working groups to develop consensus and the text of legislation in Massachusetts: Chapter 630 of the Acts of 1982 creating the Public Employee Retirement Administration; Chapter 661 of the Acts of 1983 creating the Pension Reserve Investment Management Board, and Chapter 697 of the Acts of 1987, an Act Further Regulating Public Employment Retirement in the Commonwealth. The Joint Labor-

Management Committee for Municipal Police and Fire grew out of mediation accepted by the Legislature in 1977.

8. See, John T. Dunlop, "Alternative Means of Dispute Resolution in Government, A Sense of Perspective," The Administrative Law Journal, Vol. 1, No. 2, Fall 1987, pp. 461-465.

9. John T. Dunlop, Dispute Resolution, Negotiation and Consensus Building, Dover, Mass., Auburn Publishing Company, 1984, pp. 3-28, 259-60.

10. See, Presidential Management of Rulemaking in Regulatory Agencies, (Washington, National Academy of Public Administration, 1987).

11. John T. Dunlop and Malcolm S. Salter, "Forums and Governance," Harvard Business School, 0-388-046, 1987.

ISEA Industrial Safety Equipment Association

**Written Testimony on S. 1504**
**by**
**Frank E. Wilcher, Jr.**
**President, Industrial Safety Equipment Association**

Mr. Chairman, as President of The Industrial Safety Equipment Association (ISEA) I appreciate the opportunity to present testimony in support of S. 1504.

For your background, the Industrial Safety Equipment Association is a non-profit organization composed of approximately eighty manufacturers of personal protective equipment for industrial environments. This includes hard hats, safety eyewear, and, of course, respirators which we will be discussing today.

Since its inception in 1934, the ISEA has been dedicated to the safety of workers who rely on protective equipment and to the welfare of the safety equipment industry.

As a results oriented association, ISEA is primarily dedicated to fostering public interest in safety and encouraging the use of proper equipment to deal with industrial hazards. Toward this end we work very closely with our member manufacturers and others to help them develop consensus standards so as to provide uniform product performance and use.

During my fourteen year tenure with ISEA, one of my major activities has been working with regulators, ISEA members and the end users of their products to ensure that we were working to develop the best possible products to ensure maximum safety for workers. While there obviously have been disagreements between the interested parties, we always have been able to have open discussions and a fair exchange of information, experiences, and expertise. It is my view that this kind of give and take is one of the key ingredients of a productive regulatory process.

While I understand you have expert witnesses testifying on the technical issues involved in S. 1504, a recent experience of this organization provides a scenario which clearly demonstrates the need for negotiated rulemaking as a necessary alternative to traditional regulatory processes when those processes have not worked or have broken down.

As the association representing respirator manufacturers, ISEA has tried to be actively involved in the process of promulgating 42-CFR-

84, a proposal by the National Institute for Occupational Safety and Health (NIOSH) for updating standards for respirator certification.

I would like to share the experience which demonstrates a case in point where S. 1504 would be useful.

For the past ten years, regulators, manufacturers, labor and other end users have agreed the existing standard for respirator certification, (30 CFR 11 promulgated in 1972), should be updated.

From a public policy view and our many years experience in the regulatory field, ISEA and our members think it makes sense to include experts, whether from industry, labor, or academia, in the formulative stages of developing a proposal. In this context, we continuously made overtures to NIOSH to assist them in gathering information and data for the framework of their proposal.

Regrettably, in spite of repeated attempts to provide information and create an environment of give and take between the regulators and the regulated, our efforts were ignored.

In August 1987, NIOSH published 42-CFR-84 as a proposed new rule. The proposal is simply not workable: First, it was mis-categorized as a "minor" rather than a "major" rule; it called for field testing for which technology does not yet exist to the best of our knowledge; nor did it provide a protocol for the required field testing from the agency's perspective; and it required all respirators, regardless of their end use, be tested under mining conditions when 90-95 % of U.S. respirator usage occurs in non-mining environments.

In spite of 42-CFR-84's glaring shortcomings, in an effort to avoid an unnecessary adversarial atmosphere, ISEA and other parties asked to sit down with NIOSH early on: phone calls were made, letters were written, and informal and formal constructive comments were submitted. Again NIOSH would not talk with us directly and told us the only way to participate would be through submitting written comments to the docket and through testifying at formal public hearings at which there would be no give and take.

ISEA, our member companies and many others followed the NIOSH guidelines by submitting comments and testifying at the hearings. In fact more than 200 manufacturers, end users, labor unions, other government regulators, research institutions, public interest groups and Members of Congress submitted written comments to NIOSH. It is perhaps noteworthy that almost every institution which submitted comments or delivered testimony to NIOSH had major concerns with the proposal. The vast majority asked for its recall. The list includes the Occupational Safety and Health Administration (OSHA), Tennessee Valley Authority (TVA), E.I DuPont De Nemours and Company, Virginia Power, Aluminum Company of America, the AFL-CIO, and others. In spite of such unanimity of concern, as of this date the agency continues without more than formal acknowledgement that serious concerns exist.

Mr. Chairman, to date NIOSH's only substantive response was through a written statement, distributed at the January public meetings, which attempted to address in a uniquely unorthodox and unilateral manner some of the docket comments. It shouldn't go unnoticed also, that the news media were provided NIOSH's statement before any of the parties who had been waiting many months. To the best of our knowledge, some parties have yet to formally receive any information or response from NIOSH as to our concerns, recommendations and requests.

In response to the many hours and significant expense ISEA and other affected parties invested in making suggestions, the only progress to date has been the reclassification by the Office of Management and Budget of 42-CFR-84 as a "major rulemaking", rather than its initial classification as a "minor rulemaking", thereby requiring a Regulatory Impact Analysis (RIA) which NIOSH hadn't planned on conducting. This decision was made in December, though NIOSH did not notify us of it until more than a month later. How the RIA is being developed and based on what data, we still do not know. (For the record we have offered to provide data but have been asked for none.)

This Mr. Chairman, is an exemplary case of where the regulatory process has broken down and must be put back on track to ensure maximum worker safety prevails and in a timely manner.

It is clear no one party to this process - including NIOSH, manufacturers, end users, OSHA, nor others - has all of the answers. However, review of the comments demonstrates that in spite of some differences, each of the parties has valid information and constructive ideas to bring to the debate.

The problem lies in the absence of debate. Put another way, there is no constructive dialogue or give and take.

Understanding the need for revising 30 CFR 11, and recognizing what appears to have become a stalemate, ISEA has explored potential means through which the log jam can be broken and a constructive process created to ensure the best possible means for providing optimum safety for respirator users. What we need, Mr. Chairman, is a vehicle which will get us all to the table.

After discussing the current dilemma with others - including other affected parties, academics, federal regulators, and those experienced in government regulatory processes - it appears there is a way to take advantage of this input to formulate an acceptable consensus standard. This process, as you know, is Negotiated Rulemaking -- the focus of this hearing.

Based on this experience, ISEA supports the concept and practical application of negotiated rulemaking. It is the opposite of the adversarial rulemaking environment in which we have been operating. It provides for the direct discussion of opposing points of view among interested parties. We believe it forces parties to deal with the values, needs and perceptions of each other and to prioritize their own demands, thus creating an incentive to compromise.

As you know, Mr. Chairman, the concept was first articulated by then Secretary of Labor John Dunlop in the Ford Administration. Since the early 1980's, it has been employed by several agencies to address rules involving a number of issues, both complex and relatively straightforward. The examples presented in testimony to this committee are many. The common point they illustrate is the process is extremely flexible and can be applied in a number of ways. It has been shown to be particularly effective when applied to situations involving multiple issues and parties.

We recognize negotiated rulemaking has many advantages over the traditional process. It can serve as an excellent vehicle for information sharing, not just between government and the public, but also, among public parties who may have opposing views and among government agencies who may not agree. The process can clear the air of extraneous or highly charged issues and rhetoric by making all players openly accountable for their actions and comments. All players gain a vested interest or concept of joint ownership in the final product and this usually results in higher compliance and less litigation--both highly desirable goals for any government agency. Finally, even if a true consensus cannot be reached, the process always increases the level and scope of communication among the players.

Recognizing negotiating rulemaking as a potential means for removing our current stalemate over setting new standards for respirator certification, Mr. Chairman, we have approached NIOSH and The Department of Health and Human Services to see if they are willing to try the process with 42-CFR-84. While they have not yet accepted or rejected our request, it is clear they have some reservations about the process based on their lack of experience in negotiated rulemaking.

Given the intent of your legislation, Mr. Chairman, we believe you hit the nail on the head. By providing a base of information and the availability of individuals experienced in the process, The Administrative Conference of the United States could assist agencies like HHS and NIOSH when embarking on a new process like negotiated rulemaking. A process which may be the only solution to what appears to be an intractable rulemaking stalemate which could, in our view, get the process back on track.

Thank you, Mr. Chairman.

The Jefferson
GROUP

May 12, 1988

The Honorable Carl Levin
Chairman,
Senate Subcommittee on Oversight
of Government Management
Committee on Governmental Affairs
442 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Levin:

I am President of the Jefferson Group which serves as government affairs counsel to the Industrial Safety Equipment Association (ISEA). Written testimony of the ISEA has been submitted by it's President, Mr. Frank Wilcher.

Mr. Wilcher's remarks outline that organization's experience with the National Institute for Occupational Safety and Health's (NIOSH) proposed respirator certification standard (42-CFR-84) as an ongoing case study demonstrating the need for S.1504. I, therefore, am writing you today both in support of ISEA's testimony and to add my professional endorsement to your measure as a former Deputy Assistant Secretary of Labor for Occupational Safety and Health and Chief of Staff to the Secretary of Labor in this administration. As such, I witnessed countless regulatory actions and battles. Some were successful and some were not.

Mr. Chairman, it is essential that regulators - whether Democratic or Republican, liberal or conservative - face the facts of the real world. The fact is the world is a complex place. The arena of government regulation is one of the most complicated. It is an area in which we find a panoply of parties whose interests, views, aspirations and needs must be considered. It is a world in which the threat of prolonged litigation hangs over every regulator's action and a world

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in which government must do what is best for the most, while fully considering the minority opinion.

For the regulator to be successful, whether it be in the EPA, NIOSH or OSHA, the parties in interest must, insofar as possible and appropriate within the individual Congressional mandate, be brought together; assembled at the bargaining table to submit their thoughts, ideas, information and reason. It will only be through the availability of such a process as a regulatory option that regulators will be able to regulate effectively in a pluralistic society such as ours without the process by definition being adversarial.

Mr. Chairman, S. 1504 is an important step toward making regulation a process in which not only the government, but all affected parties may participate in constructive solutions to the days' problems.

Sincerely yours,

Mark D. Cowan
President

NAM

National Association
of Manufacturers

*Government Regulation, Competition
& Small Manufacturing*

October 11, 1988

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
340 Dirksen Senate Office Building
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the 13,500 members of the National Association of Manufacturers, I would like to offer these comments for the record pursuant to your October 3 oversight hearing on regulatory reform that concentrated on the effects of Executive Order 12498, which requires agencies to publish an annual regulatory program. The NAM strongly supports the Order as an example of good and open government responding to the needs of the people.

The United States Constitution mandates the president to insure that the laws passed by Congress are implemented and enforced. Except for legislation with statutory deadlines and details of implementation, the chief executive generally has been given wide latitude on how to proceed.

The trend over the last 50 years toward increased centralization and public notice has proved beneficial to those affected by proposed rulemakings, such as businesses and consumers, as well as to the pursuit of a given administration's programs and policies. E.O. 12498, in particular, has served to coalesce the twin goals of openness and conformity with the president's views (to the extent allowed by statute).

E.O. 12498 requires each affected department and agency to submit to the director of Office of Management and Budget "its regulatory policies, goals, and objectives for the coming year and information concerning all significant regulatory actions under way or planned." The Director is then charged with ensuring that the goals and policies--as well as significant regulatory and deregulatory actions--are in keeping with the views and program of the president. The results are compiled and released to the public.

Publication of the Regulatory Program of the United States, the final step in the E.O. 12498 process, serves to notify the public of possible future regulatory activities and ensures that the policies of the executive departments and agencies reflect the views of the president. In addition, the Regulatory Program allows the president to make certain that various executive departments and agencies are

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not pursuing or contemplating duplicative or unfairly burdensome activities. At the same time, it alerts those affected by proposed regulations of the agencies' intent to embark upon a rulemaking early enough to provide the agency with information about the industry or the problem so that the agency can proceed with more knowledge at an earlier stage. By publishing the name and telephone number of the responsible agency representative, the Regulatory Program opens the process to labor, consumer, business, and other interests alike.

E.O. 12498 is a strong management tool. For that reason, we can understand that it would sometimes be resented by agency employees and department heads. But the benefits to the public far outweigh the concerns of those who would prefer that agencies be less responsive to the overall program established by the president.

Sincerely,

J. P. Carty

James P. Carty
Vice President
Government Regulation and Competition

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT
of
JAMES C. MILLER III
DIRECTOR
OFFICE OF MANAGEMENT AND BUDGET
before the
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
on
Executive Order No. 12498, "Regulatory Planning Process"
October 3, 1988

Mr. Chairman and Members of this Committee. Thank you for inviting me to come today to discuss the President's regulatory review process.

I have been involved with that process for more than a decade. At the Council of Economic Advisers and the Council on Wage and Price Stability, I helped further regulatory reform. When I rejoined the government in 1981, I became the first Administrator of the Office of Information and Regulatory Affairs. Under the direction of the Presidential Task Force on Regulatory Relief, chaired by Vice President Bush, I was responsible for implementation of Executive Order No. 12291, an Order I helped draft. When I returned to OMB, as its Director, I became responsible for the Administration's issuance of the first Regulatory Program.

It has been very exciting to see how executive regulatory oversight has grown and become more effective -- a tool that any Chief Executive can use to oversee the development of coordinated, cost-effective, efficient regulatory programs.

President Reagan, and each of his three predecessors, have undertaken a systematic, coordinated effort to coordinate the regulatory process and improve the quality of regulations. Each served its President in ways that the President desired; each differed.

Progressively, however, over the past 20 years, the executive regulatory oversight process has become more systematic and more formal, and thus more public and more visible. Regulatory coordination has improved; benefit-cost principles have been applied more consistently; the public has benefited from more carefully reasoned regulatory proposals and the inclusion in these proposals of a greater number of regulatory alternatives.

The regulatory world certainly is not perfect; but through these efforts it has gotten better.

In an ongoing cooperative effort with the agencies, the Office of Information and Regulatory Affairs has made great progress. Its staff is excellent, and very hard working. By October 1, this year, OIRA had completed review of over 20,000 draft agency regulations, over 500 of which were considered as "major" in economic or social impact. Simultaneously, the same staff reviewed over 25,000 information collection clearance packages for compliance with the standards in the Paperwork Reduction Act. And, just recently, OIRA prepared and the Administration published its fourth annual Regulatory Program. As a general matter, agency staff and program leaders have been cooperative and responsive to Administration concerns.

I am proud of what OIRA has accomplished, and of the various Administrators who have lead that Office since I left.

In 1986, in recognition of the role of OIRA, Congress amended the Paperwork Reduction Act to require that the Administrator of OIRA be appointed by the President and be subject to Senate confirmation. This combination of congressional creation of the Office, together with Presidential appointment with Senate approval, further confirms the close linkage of Congress and the President in this oversight process.

OIRA is in good hands now. Earlier this year, you confirmed the appointment of Jay Plager, the present Administrator of OIRA, and heard his testimony on his plans for OIRA. I now turn to Jay who will present the formal testimony. When he is finished, he and I will be ready to answer any questions you wish to present.

## COMMENTS OF PROFESSOR LAWRENCE SUSSKIND

Submitted at the Request of the
Senate Committee on Governmental Affairs
Concerning
S.1504, The Negotiated Rulemaking Act

I am a Professor in the Department of Urban Studies and Planning at M.I.T. and Director of the MIT-Harvard Public Dispute Program. From 1983-1986 I served as the first Executive Director of the Program on Negotiation at Harvard Law School.

My most recent book Breaking the Impasse: Consensual Approaches to Resolving Public Disputes (Basic Books, New York, 1987) reviews my work as a mediator of complex public disputes and as a consultant to the U.S. Environmental Protection Agency in its negotiated rulemaking experiments. My work on environmental dispute resolution (including negotiated rulemaking) began more than 10 years ago with the publication of Resolving Environmental Regulatory Disputes (Cambridge, Schenkman, 1985).

My extensive evaluation of EPA's negotiated rulemaking experiences are presented in "The Theory and Practice of Negotiated Rulemaking," (Yale Journal of Regulation 3, 1, 1985, pp 133-165).

I would enclose wholeheartedly the comments submitted to the Committee on Governmental Affairs by Philip J. Harter (5/13/88), particularly his specific comments on pp. 15-16 of his prepared testing.

In addition, I would endorse the detailed comments submitted by Thomas E. Kelly (5/13/88) Director of EPA's Office of Standards and Regulations (pp 11-14).

In general, Mr Harter and Mr. Kelly point out the strengths of the proposed bill (S.1504) as well as some of the minor weaknesses in the current draft.

I also think that the detailed suggestions of the Chemical Manufacturers Association (5/13/88) are quite helpful. There is nothing they suggest that is inconsistent with what Harter and Kelly propose.

Marshall Breger's testimony (5/3/88) puts too great an emphasis on the role of ACUS, but Harter and Kelly suggest good ways of correcting this.

I cannot agree with Kelly Brown (Ford Motor Company) or David Doniger (NRDC). The Ford representative proposes to narrow elegibility for participation in Committees. In my view, this would be a mistake. Mr. Doniger thinks that legislation to codify negotiated rulemaking is premature. I disagree. Ten more experiments will not add much more to our understanding of the key issues involved. (I don't disagree at all with Doniger's proposal for compensation for Committee members who need it.)

This is one of those rare instances in which a good idea has been thoroughly tested, carefully documented and wisely evaluated. The proposed bill -- with the modifications suggested -- is the right way to proceed. The results should be greater fairness, efficiency, and wisdom in the rulemaking process.

**U.S. Chamber of Commerce**

1615 H Street, N.W.
Washington, D.C. 20062
202/463-5602

*Albert D. Bourland*
*Vice President*
*Congressional Relations*

October 13, 1988

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
340 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce and trade and professional associations, offers its views on Executive Order No. 12498, the "Regulatory Planning Process."

Today, more than 100 federal agencies issue regulations on all aspects of American life. The Federal Register publishes more than 5,000 regulatory documents each year. Given the breadth and impact of these administrative rules, the regulatory process must be made as efficient and effective as possible. Executive Order No. 12498, which requires executive departments and agencies to submit annual statements outlining their regulatory priorities and objectives, is a highly valuable tool, and the Chamber supports its continued implementation.

As you are aware, agency rule-making procedures have come under intense scrutiny and criticism during the last decade by academia, interest groups, the private sector and even federal agencies themselves. Critics express concern over the burdensome nature of the rule-making process, the poor quality of the rules, the length of time it takes to promulgate them and the frequency of litigation that follows.

The direct cost to the taxpayer for often unnecessary, duplicative and contradictory regulations has been estimated to exceed $100 billion per year (between $570 - $1,700 per year for each household).

Many companies have been forced to hire employees solely for the purpose of complying with burdensome federal paperwork and recordkeeping requirements, which affect the cost of goods and services and the competitive edge in the market that American companies now possess. Some small companies simply cannot afford to hire such employees and, consequently, are forced out of business.

Executive Order No. 12498 helps to provide the business community and others with knowledge of agencies' intentions and their planned directions. Such knowledge allows businesses time to comment, comply and adjust their practices as needed.

The Chamber requests that this Committee continue to support Executive Order No. 12498, the "Regulatory Planning Process," and that this letter be made a part of the hearing record.

Sincerely,

Albert D. Bourland

# Environmental federalism

Robert M. Schwab

NEARLY ALL MAJOR federal environmental legislation divides the responsibility for controlling pollution between the federal government and the states. The exact division of responsibilities varies substantially from statute to statute.

Consider the Clean Air Act. It requires the federal government to set air quality standards for each of six pollutants and to establish performance standards for new stationary sources of pollution (such as factories and utilities) and mobile sources (such as automobiles). States are required to develop implementation plans, which must be approved by the Federal government, to reach these goals; states also share the responsibility for enforcement. In sharp contrast, under the Clean Water Act the individual states are directed to set water quality standards. We thus have uniform national standards for air quality but state-specific standards for water quality.

Which approach is better? Should we move toward greater centralization, thus giving more responsibility for controlling pollution to the federal government? Or should we encourage further decentralization and allow state and local governments a greater voice in environmental policy?

This question is part of a much broader issue. The debate over the proper division of governmental responsibilities is longstanding. It was a key issue in the framing of the Constitution in the 1780s; it lies at the heart of the debate over the Reagan administration's call for a "new federalism" in the 1980s. Many of the questions about environmental federalism should be familiar to those who have thought about other issues in federalism.

## Decentralized policymaking

The case in favor of decentralized decision making is simple, yet powerful and persuasive. For the moment, let's set aside the question of who should set policy and look at the principles we would like to see embedded in policymaking decisions. "Optimal" environmental policy—from an economic standpoint, at least—requires us to continue to reduce pollution in all parts of the country up to the point that the cost of further reducing pollution (what is known as marginal abatement cost) equals the benefits from that reduction (that is, marginal social damage). Focusing only on the economics of the issue, if it costs society $100 to reduce emissions by one additional ton but the benefits from doing so were valued at $200, we would be wise to cut back on pollution further; if, on the other hand, benefits were valued at only $50, we have set environmental standards too high. If we continue with this line of argument, the logic behind the economic principle that the optimal standard is such that marginal abatement cost equals marginal social damage becomes clear.

While it is true that we should apply the same *principle* in every region, we should not set the same environmental *standard* everywhere unless the costs and benefits of pollution control are the same in each region. There are excellent reasons to believe that this is not the case. For example, different industries are clustered in different regions, and it is much more costly for firms in some industries to reduce emissions than others. Thus differences in regional industry mix imply differences in regional abatement costs. Differences in meteorology, topography, and land-use patterns also play important roles in abatement costs. Few would disagree with the proposition that it will be much more costly for Los Angeles to reach any given level of air quality than most other cities; by one estimate, the Los Angeles area would have to reduce gasoline consumption by 82 percent in order to meet the air quality standards set under the Clean Air Act.

Similar considerations arise on the benefit side of the equation. Benefits, after all, are to some extent subjective. It could well be the case that the residents of some states would be willing to pay $200 for a slightly cleaner environment, but that residents of others would be willing to pay only $50. Population size also plays a role. Everyone in an area suffers the damages pollution causes. Therefore, everything else being equal, the greater the population in an area, the greater the benefit from a cleaner environment.

Ongoing research sponsored by RFF and funded by the National Science Foundation points to the validity of this argument. Paul R. Portney, Albert M. McGartland, and Wallace E. Oates have assembled data on damages and abatement costs for total suspended particulates (TSP) for Baltimore and St. Louis. Their preliminary estimate is that the optimal standard for TSP concentrations for Baltimore is nearly 50 percent less stringent than the optimal standard for St. Louis. That is, if we were to equate the costs and benefits of reducing TSP in both cities, the permissible level of pollution would need to be nearly twice as high in Baltimore.

How should we divide the responsibility for setting environmental policy in order to reach this optimal outcome (again recalling that we are only focusing on economic issues)? Federal legislation is rarely sensitive to regional differences in costs and benefits. Typically, federal legislation implies uniform standards; for example, under the Clean Air Act, the federal government sets uniform maximum allowable levels of pollution. Therefore, vesting the federal government with the authority to set environmental policy is unlikely to lead to an optimal outcome.

This line of reasoning should sound

familiar to anyone who has been involved in the debate over fiscal federalism. It would make little sense to provide the same menu of public services in every community, or for the federal government to try to tailor policies to meet the local circumstances in each community. Thus we allow state and local governments to decide how much to spend on education, when trash is to be collected, and which beats police officers will patrol. The logic leading to this conclusion also suggests that state and local governments may be in a better position than the federal government to choose the correct level of environmental quality.

## Possible problems

Many people would accept the basic argument in favor of decentralization, but would continue to urge a strong role for the federal government in environmental matters nonetheless. They would contend that while the outcome under federal uniform standards is unlikely to be optimal, it is better than the outcome that would emerge if we were to allow state and local governments to set environmental policy.

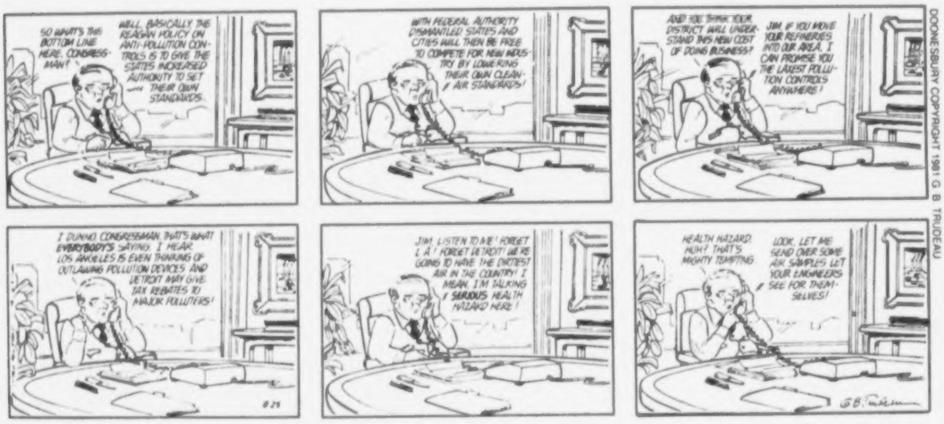
Though it might not be immediately obvious, most of the arguments against decentralization turn on a single principle that has a strong basis in economic logic. If there are costs or benefits associated with the environmental policies adopted by one region that are borne by the residents of other regions, then it is unlikely that decentralized decision making will lead to an optimal outcome. We can apply this principle in a range of circumstances.

The clearest cases are those where pollution generated in one state crosses political boundaries into another. For instance, if Illinois firms are forced to reduce pollution, we would expect the citizens of Illinois (and, hopefully, Illinois policymakers) to take into account the benefits from a cleaner environment that Illinois citizens would realize. Thus, Illinois would require its firms to reduce pollution to the point that marginal abatement cost equalled marginal damage suffered by Illinois residents. Under such a decentralized approach, we would not expect Illinois citizens to necessarily take into account the benefits Indiana residents receive. An optimal policy would require Illinoisans to go further and continue to reduce pollution until marginal abatement cost equalled the sum of damages to both Illinois and Indiana residents.

Clearly, in many cases this argument against decentralization is quite persuasive. The problems in coordinating efforts by Delaware, Virginia, Maryland, the District of Columbia, and Pennsylvania to clean up the Chesapeake Bay are well documented (and the Chesapeake is often offered as one of the more successful cooperative undertakings). In some cases, whether or not a pollutant is local is a policy issue; damages from sulphur dioxide emissions can be contained in a small area or dispersed over a much larger area if firms are required to use tall stacks. Some pollutants are international, acid rain being a good example, as the strained relations between Canada and the U.S. can attest. Some are truly global, carbon dioxide's impact on the climate (often called the greenhouse effect) and the impact of chlorofluorocarbons on the ozone shield being extreme examples of environmental issues that cannot be addressed by states or even nations. In such cases, the benefits from controlling pollution extend well beyond traditional political borders.

Many pollutants, however, cause damages over a much more limited area. Lead, carbon monoxide, and TSP (total suspended particulates) are good examples. In many cases, the control of hazardous waste sites and the establishment of drinking water standards also fall into this category.

Similar issues arise repeatedly when assessing fiscal federalism. Suppose the residents of Community A build parks which are used not only by residents of A but by those of Community B as well (an


SO WHAT'S THE BOTTOM LINE HERE, CONGRESSMAN?
WELL, BASICALLY THE REAGAN POLICY ON ANTI-POLLUTION CONTROLS IS TO GIVE THE STATES INCREASED AUTHORITY TO SET THEIR OWN STANDARDS.
WITH FEDERAL AUTHORITY DISMANTLED STATES AND CITIES WILL THEN BE FREE TO COMPETE FOR NEW INDUSTRY BY LOWERING THEIR OWN CLEAN-AIR STANDARDS!
AND YOU THINK YOUR DISTRICT WILL UNDERSTAND THIS NEW COST OF DOING BUSINESS?
JIM, IF YOU MOVE YOUR REFINERIES INTO OUR AREA, I CAN PROMISE YOU THE LAXEST POLLUTION CONTROLS ANYWHERE!
I DUNNO, CONGRESSMAN, THAT'S WHAT EVERYBODY'S SAYING. I HEAR LOS ANGELES IS EVEN THINKING OF OUTLAWING POLLUTION DEVICES AND DETROIT MAY GIVE TAX REBATES TO MAJOR POLLUTERS!
8-29
JIM, LISTEN TO ME! FORGET L.A.! FORGET DETROIT! WE'RE GOING TO HAVE THE DIRTIEST AIR IN THE COUNTRY! I MEAN, I'M TALKING SERIOUS HEALTH HAZARD HERE!
HEALTH HAZARD, HUH? THAT'S MIGHTY TEMPTING.
LOOK, LET ME SEND OVER SOME AIR SAMPLES. LET YOUR ENGINEERS SEE FOR THEMSELVES!
G.B. Trudeau

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**Some fear that in their eagerness to attract new business and jobs, local officials would set environmental standards that are too lax.**

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example of a "fiscal spillover"). Under these conditions, we would expect that Community A had built too few parks. The standard policy solution in this case would be a grant from the federal government to Community A to encourage it to build additional parks.

We can analyze a second argument against decentralization in this framework. People throughout the country derive benefits from the quality of the environment in unique national sites such as national parks and wilderness areas; the residents of New York care about clean air in Yellowstone, as do the residents of Wyoming and Idaho. In many ways this issue is identical to the interjurisdictional pollution problem discussed above, though here the damages from pollution spill over state boundaries even though the pollution itself does not. Again, optimal policy almost certainly requires some federal role.

As a third argument, there are sometimes gains from uniformity and coordination. (Anyone who doubts this should try playing a tape made on a Beta videocassette recorder on a VHS machine, or using a piece of software written for an Apple computer on an IBM.) In the context of environmental policy, it would be very expensive to demand that Detroit make cars that meet different standards in Montana, New Jersey, and so on. Clearly there are some benefits from uniform standards; automobiles are probably the most important example. But even in the case of automobiles, the benefits to be gained from a policy on uniformity do not rule out the possibility that the "correct" number of standards may be a happy medium between the current number—two (the Clean Air Act allows California to set its own standards for auto emissions)—and fifty, that is, one that applies to each state.

## Interjurisdictional competition

A fourth argument against allowing lower levels of government to set environmental policy focuses on the effects of interjurisdictional competition. The fear is that in their eagerness to attract new business and jobs, local officials would set environmental standards that are too lax. Thus, so this argument goes, the federal government must set environmental policy in order to "save the states from themselves." Such a stance is consistent with a more general view that nearly all forms of competition among jurisdictions are destructive. The Advisory Commission on Intergovernmental Relations (the focal point for interest in federalism issues within the federal government) for years argued that state and local governments should be encouraged to cooperate with one another.

In the last several years, however, there has emerged a strong sense that competition among governments can be beneficial, just as competition among firms can be beneficial. According to this view, competition forces local government to make decisions that are in the best interest of their constituents. Thus competition stops local officials from overspending; if they were to try to set public budgets that were too high, firms would vote with their feet and move to competing communities.

The following simple example captures the spirit of this argument in the context of environmental policy. Suppose Illinois were about to set a standard for some pollutant. Who would bear the costs associated with this new policy? Since Illinois competes against other states to attract and hold firms, clearly the burden cannot fall on Illinois firms; they have the option to move to another state. Therefore the cost of reducing pollution must fall on Illinois residents in the form of fewer jobs and lower wages.

Under these circumstances, what level of environmental quality should Illinois policymakers set? They might reason as follows. Illinois residents will pay the costs of reducing pollution. Therefore if Illinois policymakers act in the best interest of their constituents, they should set a standard such that the costs of reducing pollution further are just balanced by the benefits. If they set a less stringent standard, Illinois residents would be willing to sacrifice additional jobs and wages in return for a cleaner environment; if they set a more stringent standard, the benefits from less pollution would not be worth the cost. This is exactly what optimal environmental policy requires: marginal abatement cost should equal marginal social damage.

Undoubtedly the real world is much more complicated than the above situation. Firms cannot instantaneously move from Illinois to Hawaii; Illinois firms may have quite a bit of influence with Illinois lawmakers; the costs of pollution control will be concentrated among workers in certain industries while the benefits of a cleaner environment are diffuse; residents of other states will realize some of the benefits if Illinois firms generate less pollution. But this illustration does make an important point. Competition among jurisdictions implies that the costs of government would be borne largely by those who realize the benefits from those policies and will therefore encourage efficient public decisions.

## Children and grandchildren

Finally, as some people have asked, if we vest state and local governments with the authority to set environmental policy, will they properly take into account the interests of future generations? Will communities be inclined to follow policies that yield benefits now (such as more jobs) but would result in substantial damages in the future (such as increased exposure to long-lived pollutants like hazardous wastes)? Problems of this kind would seem to be more acute at the state and local levels than at the federal level. We would presumably all want the federal government to take into account the interests of our children since it is likely that they will live somewhere in this country. But at least some of our children will live in communities elsewhere, and therefore their environmental heritage will depend on the decisions of others. Geographic mobility, so this argument goes, could result in myopic local decisions and suboptimal environmental quality for future generations.

This line of reasoning is not altogether persuasive. There is substantial evidence that many of the factors that determine the quality of life in a community are reflected in community property values—that is, people are willing to pay more to live in a community with good schools, a low crime rate, and a clean environment. Suppose a community were considering allowing a new firm to locate in that community, and suppose further that this firm would cause $100 worth of environmental damages in the future. If environmental quality is reflected in property values, the value of homes in this community would fall by (the present value of) $100 if the firm were allowed to enter. At least in this simple case, current generations could not escape the future costs and benefits of their environmental decisions. Here again, the example ignores some important issues; in particular, it assumes that future residents are aware of and can evaluate the damages from long-lived pollution. But it does suggest that some of the concerns about decentralized policymaking need to be reevaluated.

## Sensible solutions

These considerations are not meant to suggest that we should abolish the U.S. Environmental Protection Agency and ask state and local governments alone to protect the environment. But I would argue that we should seriously consider moving some policymaking responsibility to lower levels of government, while still leaving the federal government with an important role in environmental issues. There are some strong arguments in favor of decentralization. An environmental policy that is correct in one region is unlikely to be correct in all. Federal regulation is rarely sensitive to these differences; instead, it often implies a single uniform policy in all regions.

It is important not to minimize the problems associated with this proposal. In particular, the spillover problem is difficult; the damages from some pollutants do not respect state boundaries. But sensible solutions may be available. Federal matching grants to state and local governments are often used to deal with the problem of fiscal spillovers. Perhaps similar policies (for instance, grants from the federal government to a state in return for an agreement to control pollution more tightly) would be effective in the interjurisdictional pollution problem. Further, we might envision a regulatory structure where states (and possibly lower levels of government) assume the responsibility for controlling some pollutants while the federal government retains the responsibility for others. It is not clear that we can solve all of the problems in environmental federalism, but the issues are sufficiently important that they deserve careful attention. ■

*Robert Schwab is an associate professor of economics at the University of Maryland. This article is part of the research on environmental federalism he conducted while he was a Gilbert F. White Fellow at RFF during the 1987–88 academic year.*

# ENVIRONMENTAL FEDERALISM: ALLOCATING RESPONSIBILITIES FOR ENVIRONMENTAL PROTECTION

Staff Working Paper
September 1988

The Congress of the United States
Congressional Budget Office

## PREFACE

This Congressional Budget Office staff working paper examines the division of responsibilities among federal, state, and local governments in the field of environmental protection. The study is an interim report on work in progress in response to a request from the Senate Committee on Governmental Affairs. It examines trends in the allocation of environmental program responsibilities, and explores how economic criteria might be used to facilitate the assignment of public-sector responsibilities to different levels of government. Future work will seek to investigate the advantages and limitations of these criteria in practical applications. In keeping with the mandate of the Congressional Budget Office to provide objective analysis, the paper makes no recommendations.

Frances G. Sussman of CBO's Natural Resources and Commerce Division wrote the paper under the supervision of Elliot Schwartz and Roger C. Dower. Valuable comments and assistance were provided by Everett M. Ehrlich before his departure from CBO. Martin Zober, Peter Zimm, and Lynn Vendinello provided research assistance. Wallace E. Oates, Claudia Copeland, Katherine Sparks, and Verdon Staines made a number of useful suggestions on earlier drafts. Michael Deich provided helpful comments during the preparation of the paper. The paper was edited by Francis Pierce and typed by Patricia B. Joy.

James L. Blum
Acting Director

September 1988

## CONTENTS

SUMMARY vii

I INTRODUCTION 1

II TRENDS IN ENVIRONMENTAL FEDERALISM 3

The Allocation of Program Responsibility 4
Recent Trends in Funding Responsibility 10
An Evolving Partnership 20

III ALLOCATING GOVERNMENTAL RESPONSIBILITY FOR ENVIRONMENTAL PROTECTION 21

The Notions of Economic Efficiency and Economic Equity 21
Resource Allocation and Governmental Responsibility 23
Some Economic Criteria 25
Responsibilities for Specific Program Activities 32

TABLES

S-1. EPA Operating Budget and Grants to States for Air, Water, and Hazardous Waste Programs ix

S-2. State Budgets and EPA Grants to States for Air, Water, and Hazardous Waste Programs x

1. EPA Budget for Environmental Programs 12

2. EPA Operating Budget by Function 13

3. EPA Operating Budget for Environmental Programs 15

4. Grants to States as Percentages of EPA Operating Budget, by Program 16

5. Total State Budgets for Air, Water, and Hazardous Waste Programs 18

6. Grants to States as a Percentage of Total State Budgets, by Program 19

BOXES

1. The Distribution of Responsibilities 5

2. Evaluating Trade-offs: The Regulatory Flexibility Act 24

## SUMMARY

Federal, state, and local governments play diverse roles in designing, managing, and funding environmental programs. This division of responsibility may be critical in determining the level of environmental protection that occurs and the type of program that develops. Some of the mature environmental programs, as in air and water quality and hazardous waste management, are designed with a built-in expanding role for state governments; under these programs, a growing portion of both program and funding responsibility is being delegated to states by the federal government. In areas of emerging importance such as toxic air pollution, indoor air pollution, and groundwater contamination, states are taking the initiative to plan and implement programs concurrently with federal efforts.

As the role of the states expands, federal funding for many environmental programs is either being reduced or is not growing as quickly as total program costs, so that states are funding a growing percentage of the costs. States and municipalities complain that they are overburdened by their new responsibilities and are or will be unable to raise the necessary revenues to continue to manage and enforce existing programs and develop new programs.

This paper consists of two parts. The first part examines the existing allocation of program and funding responsibilities among levels of government for current environmental programs. The second part suggests ways in which economic criteria can contribute to understanding whether or not the allocation of responsibility is appropriate.

## THE CURRENT DIVISION OF RESPONSIBILITY FOR ENVIRONMENTAL PROTECTION

Environmental protection programs are initiated, designed, implemented, and funded at all levels of government. The division of responsibilities among federal, state, and local levels of government ranges from complete federal control of some programs to a federal-state partnership in others and to independent state actions in some newer programs.

The current allocation of program and funding responsibilities is primarily the result of federal legislative changes over the last 20 years. Until the late 1960s and early 1970s, federal involvement in environmental protection was minimal. As interest in environmental issues grew, participation in environmental protection at all levels of government also grew. This was reflected in part by the passage of several major federal statutes in the 1970s that established expanded roles for the federal government and laid out increased responsibilities for the states. Several of these statutes, notably the Toxic Substances Control

Act and the Marine Protection, Research and Sanctuaries Act, assign the federal government primary regulation responsibility.

In contrast, the major air and water quality and hazardous waste management programs provide for the delegation of all or part of the responsibility for daily implementation to the states. As these programs have evolved, the federal government has maintained a strong role in enforcement, overseeing and approving state plans and providing technical guidance and funds for research, while states have been delegated more and more funding and program responsibilities.

For example, under the Clean Air Act, the Environmental Protection Agency (EPA) sets national standards for air quality while states, through their State Implementation Plans, have primary responsibility for meeting these criteria. Under the Clean Water Act, states may be delegated responsibility for issuing permits and for portions of the municipal wastewater treatment program. The Resource Conservation and Recovery Act gives states authority to administer all or part of EPA's hazardous waste management program. Currently, every state has been approved to administer all or part of at least one of these programs. In addition, states are providing the impetus for developing protection plans in many areas where no comprehensive federal approach exists, such as indoor air pollution and groundwater management.

As the Table S-1 indicated, EPA's operating budget and federal grants to states have both declined or grown in real terms only slightly as federal and state responsibilities have grown. Grants to states for air, water, and hazardous waste have fallen by almost half since the peak of $477 million (in 1987 constant dollars) in 1979, and total EPA expenditures on air, water, and hazardous waste have fallen by nearly one-quarter during the same time period; the percentage of the EPA budget for air, water, and hazardous waste that is devoted to state grants has declined also. Estimates by the Congressional Budget Office suggest that states have been funding a growing percentage of these programs. In 1982, EPA grants to states constituted approximately half of total state expenditures on air and water quality and three-quarters of state hazardous and solid waste management costs (see Table S-2).1/ In 1986, the federal portion had dropped slightly for air quality and had declined to one-third for water quality and to 40 percent for waste management.

## ALLOCATING PROGRAM AND FUNDING RESPONSIBILITY

The roles to be played by federal, state, and local governments in emerging environmental issues have not yet been fully defined. In addition, governmental participation in the more mature air and water programs, and in funding and decision making, continues to change. In order to evaluate the division of responsibility, it is helpful to have guidelines for determining which levels of government are best suited to different activities. From an economic

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1. Of course, other criteria also are used to evaluate environmental programs, such as their impacts on human health and on the ecology.

TABLE S-1. EPA OPERATING BUDGET AND GRANTS TO STATES FOR AIR, WATER, AND HAZARDOUS WASTE PROGRAMS

| | EPA Operating Budget (In millions of 1987 dollars) a/ | Grants to States (In millions of 1987 dollars) a/ | Grants as a Percentage of EPA Budget |
|---|---|---|---|
| 1978 | 937 | 384 | 41 |
| 1979 | 1,113 | 477 | 43 |
| 1980 | 1,031 | 353 | 34 |
| 1981 | 1,016 | 324 | 32 |
| 1982 | 754 | 267 | 35 |
| 1983 | 697 | 251 | 36 |
| 1984 | 707 | 251 | 36 |
| 1985 | 809 | 267 | 33 |
| 1986 | 834 | 276 | 33 |
| 1987 | 872 | 289 | 33 |
| 1988 | 845 | 264 | 31 |
| 1989 | 825 | 256 | 31 |

SOURCES: Congressional Budget Office, from data reported in Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; and Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988).

NOTE: 1978 through 1987 data are actual budget authority; 1988 data are estimated budget authority; 1989 data are President's requested budget authority.

a. Includes air quality and water quality control, drinking water programs, and solid and hazardous waste management programs.

TABLE S-2. STATE BUDGETS AND EPA GRANTS TO STATES FOR AIR, WATER, AND HAZARDOUS WASTE PROGRAMS

| | Total State Budgets (In millions of 1987 dollars) | | | EPA Grants as a Percentage of State Budgets | | |
|---|---|---|---|---|---|---|
| | Air | Water a/ | Hazardous Waste b/ | Air | Water a/ | Hazardous Waste b/ |
| 1982 | 210 | 236 | 64 | 49 | 49 | 76 |
| 1983 | 213 | 274 | 76 | 45 | 38 | 66 |
| 1984 | 206 | 296 | 110 | 46 | 35 | 47 |
| 1985 | 202 | 326 | 146 | 48 | 34 | 41 |
| 1986 | 213 | 336 | 169 | 46 | 33 | 40 |

SOURCES: Congressional Budget Office, from Congressional Budget Office survey of state water and hazardous waste budgets; from federal grant data reported in Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988); from state air budget data reported in State and Territorial Air Pollution Program Administrators and the Association of Local Air Pollution Control Officials, *Air Permit and Emissions Fees: Results of a Survey*, prepared by Mary M. Sullivan (Washington, D.C., April 1987); and from unpublished additional state air budget survey data provided by the State and Territorial Air Pollution Program Administrators.

a. Includes water quality programs; some drinking water programs may not be included.

b. Includes both hazardous and solid waste programs.

perspective, the division should promote levels of protection and types of programs that are efficient and equitable. The standard of economic efficiency implies that a program should balance benefits and costs, that benefits should be achieved at the lowest cost possible, and that benefits should accrue to the people and groups who place the most value on them. The standard of equity applies to the distribution of benefits and costs; for example, equity may imply that the costs of environmental programs should be borne by those responsible for the pollution to the extent that they are able to bear the burden, or that the benefits should be evenly distributed.2/

Environmental programs involve five broad categories of responsibility, each of which may be carried out by federal, state, or local levels of government:

- Setting goals and standards--defining program goals and setting standards for quality or emissions;
- Designing and implementing programs--designing, managing, and revising plans for achieving standards and goals;
- Enforcement--ensuring that program goals and requirements are met by the regulated community;
- Research and development--developing and providing technical guidance for standard setting, program design, and enforcement; and
- Funding--providing funds necessary to meet administrative and research costs.

In general, the unit of government best suited to undertake each of these responsibilities is the level best able to assess costs and benefits accurately and to act on that assessment to produce environmental programs that are efficient and equitable. Levels of government typically vary in their abilities to do this, depending on the activity involved. The appropriate level of government to deal with an environmental problem also depends on the type of environmental problem, the available control options, and the characteristics of the governmental jurisdiction.

Smaller units of government tend to be closer to the environmental problem and to the persons and firms affected. They may have better information on local circumstances and thus be able to assess costs and benefits more accurately. If so, they may be able to provide programs that address specific local problems and circumstances. Smaller units of government may also have an advantage in terms of flexibility and the ability to provide more innovative solutions to environmental problems. These same characteristics may also enable lower levels of government to be more responsive to equity concerns.

Larger units of government may be able to provide more efficient and

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2. State budget estimates were obtained, in part, from an informal Congressional Budget Office survey. The limitations of these data are discussed in Chapter II.

equitable environmental protection under certain circumstances. If a substantial number of people and firms receiving benefits or incurring costs under a program are located outside the boundary of a jurisdiction (externalities), then it is less likely that local government will take into account the preferences of these groups and accurately assess the level and distribution of the costs and benefits. In addition, some activities (such as setting health or technology-based standards) require substantial amounts of technical information. Small government units may not be willing to incur the costs of developing or acquiring this information. Finally, a program may have economies of scale in administration or construction, as in issuing permits or building wastewater treatment plants. If so, then larger government units may be better able to capture these economies and provide lower-cost services.

The degree to which these general characteristics will give preference to one level of government over another depends on the specific program activity. Different program activities also generate different levels of tension between the economic goals of efficiency and equity. Consider, for example, the level of government with control over standard setting. Variations in local standards provide an opportunity for flexibility in responding to unique regional circumstances, and allow the adoption of environmental quality levels that reflect local benefits and costs. On the other hand, uniform national standards provide a minimum standard of health for everyone, and thus may be justifiable on other than efficiency grounds.

As another example, the responsibility for funding a public program typically parallels program responsibility. The implicit assumption is that the governmental unit responsible for daily implementation of a program is in the best position to develop the most appropriate methods for raising program revenues. This may not always be equitable and efficient. The costs of program management and compliance imposed by federal regulations may be substantial at the state and local levels. The burden of complying with these regulations may also be unevenly or unfairly distributed among jurisdictions; if so, then additional federal support may be justified on the basis of equity and as a mechanism for persuading state and local governments to comply with national regulations.

## CHAPTER I

## INTRODUCTION

The relationship between federal, state and local governments in the design and implementation of environmental protection programs has gone through a number of significant changes over the last 30 years. From being primarily a state concern in the 1950s and 1960s, environmental protection became increasingly a federal concern during the 1970s. Since then a partnership of sorts has evolved, with different levels of government taking on different responsibilities.

In the coming decade, the nature and effectiveness of this partnership will be increasingly tested. Budget constraints are forcing all levels of government to reexamine their obligations under existing environmental programs. New or unaddressed environmental concerns have arisen that place additional constraints on governmental ability to cope effectively with any one problem. The Congress will be dealing with these constraints as it debates reauthorization of maturing environmental programs, as it moves to confront new problems, and as it determines budgetary priorities for the environment. The resulting allocation of roles and responsibilities for environmental protection among the different levels of government will determine, in large part, the types of programs that are developed, the effectiveness of these programs, and ultimately the level of environmental quality that is achieved.

Federal, state, and local governments are not equally capable of handling all the different activities that are associated with environmental protection programs. One key to effective environmental management will be the Congress's ability to assign (directly or indirectly) roles and responsibilities to those levels of government best suited to specific tasks. The purpose of this staff working paper is to report on work in progress to assist the Congress in making these decisions. Specifically, this report presents the first two of three parts of a larger study on environmental federalism.

The first part of the study, presented in Chapter II, describes the governmental partnership that appears to be evolving for many current environmental programs. By design or default, current programs embody various forms of environmental federalism. The division of technical, administrative, and financial functions that has developed can provide some insight into the ability of governments to undertake various parts of environmental management, and the types of problems that are likely to arise. Within this context, the emerging relationship between levels of government in dealing with new problems can also be informative.

The second part of the study, presented in Chapter III, aims to provide an analytical structure for allocating environmental responsibilities among different levels of government. The paper adopts an economic viewpoint that provides one set of broad criteria for assigning responsibilities and indicating the efficiency and equity implications of alternative assignments. Used in conjuction with the information on current trends in environmental federalism, this approach can provide a set of guidelines for evaluating current programs and designing effective new programs.

The third part of the analysis, to be reported in a later study, will investigate the potential for applying the general guidelines set forth here to specific problems of allocating governmental responsibility.

# CHAPTER II

# TRENDS IN ENVIRONMENTAL FEDERALISM

The responsibility for environmental protection programs is shared in varying degree among federal, state, and local governments. Some processes are completely under federal control, such as the regulation of new and existing chemicals under the Toxic Substances Control Act (TSCA). Other environmental programs are primarily under the jurisdiction of state and local governments--for example, the regulation of indoor air pollution and groundwater management. Still others, notably air and water quality control programs, are the responsibility of both federal and state governments.

Environmental protection programs have increased markedly in the last two decades, both in number of statutes and in breadth of coverage. Until the 1970s pollution was considered a state and local concern, and programs and funding originated at the state and local levels. Federal activity concentrated on research and development, and on providing limited technical and financial assistance to state and local governments as in the construction grants program. Increased awareness of environmental problems in the 1960s and concern about inconsistencies among state statutes, together with a need to assure continued state involvement, culminated in the formation of the Environmental Protection Agency (EPA) in 1970.1/ The passage of the Clean Air Act (CAA) amendments in 1970 and the subsequent enactment of major statutes governing water quality (1972) and the disposal of hazardous wastes (1976) assured a strong federal presence in overall program direction and development, as well as a federal financial commitment both to federal programs and to support for state and local programs. The federal government has also assumed primary responsibility for the administration of several new statutes, including TSCA and the Marine Protection, Research and Sanctuaries Act (MPRSA), and has been assigned expanded duties under amendments to the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA).

While some programs remain primarily in the federal domain, the major air, water, and hazardous waste programs have gradually evolved into federal-state partnerships. As these programs have matured, the federal role in program

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1. For a comprehensive look at the legislative development and changing federal-states roles in environmental protection in the decades preceding 1982, see Claudia Copeland, *Federal-State Relations in Transition: Implications for Environmental Policy*, a report prepared by the Congressional Research Service for the Senate Committee on Environment and Public Works and issued as a Committee print, Serial No. 97-7, February 1982.

management and in funding of state activities has changed. States currently administer many portions of the major programs, while the federal government sets standards, oversees and approves state programs, and steps in to administer programs as needed.

Newer programs are emerging in a number of areas, such as groundwater protection and air toxics. In these areas, the debate concerning the appropriate roles for federal and state governments has been vigorous. Currently, the federal government provides funds for research and program development, and assists states with technical guidance and financial support; many states have already undertaken the task of designing and implementing programs to address these problems.

Federal funding of environmental protection activities has declined in real terms over the last 10 years, although slight increases have occurred in the second half of this decade. In the air and water programs and overall, EPA's budget has declined, as have grants to state and local governments. The percentage of EPA's total operating budget apportioned to state grants was also declined, for each program individually and for all programs combined. In part, these trends reflect federal budget pressures. They also suggest that financial responsibility is being shifted to the states along with program responsibility. As a result, states appear to be funding a growing percentage of the costs of running their programs.

## THE ALLOCATION OF PROGRAM RESPONSIBILITY

Nearly all the major air, water and hazardous waste programs operate under some form of federal-state partnership in which states implement federally approved plans while EPA retains authority for setting the standards and overseeing the plans (see Box 1).2/ States are also developing programs to deal with environmental problems that may not be adequately addressed by existing federal requirements. In order to highlight the types of responsibilities for which states are currently responsible, this section discusses the existing and emerging environmental programs for which states have been delegated or assumed substantial control. The federal government also has numerous responsibilities under statutes not discussed here, including the Toxic Substances Control Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Marine Protection, Research and Sanctuaries Act.

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2. For reviews of the major federal programs for air, water, and hazardous waste, see Congressional Research Service, *Summaries of Federal Environmental Laws Administered by the Environmental Protection Agency*, Report No. 87-226 ENR (April 15, 1987); and Sheldon M. Novick and others, eds., *Law of Environmental Protection*, vols. 1 and 2 (New York: Clark Boardman Company, Ltd., 1987).

### BOX 1
### The Distribution of Responsibilities

Every environmental program involves a wide range of actions, from defining policy goals to designing permit systems and enforcing regulations; these activities fall into five broad categories. The distribution of responsibilities among levels of government varies by statute and type of activity.

Setting goals and standards--defining the goals of the program and setting standards for water or air quality, as applicable, and for allowable emissions. Authority for setting standards is reserved to the federal government under most major environmental statutes, although the Clean Water Act requires each state to set standards for bodies of water within its jurisdiction.

Designing and implementing programs--determining what techniques will be employed to meet goals and standards and designing, revising, and administering programs. Responsibility for design and implementation is shared by federal and state governments to varying degrees. At one extreme, the Superfund legislation and the Toxic Substances Control Act reserve virtually all program management for the federal government. The Federal Insecticide, Fungicide and Rodenticide Act grants primary enforcement and certification authorities to states, but reserves most registration and other program functions for EPA. At the other extreme, the major acts--the Clean Air, Clean Water, and Safe Drinking Water Acts and the Resource Conservation and Recovery Act (RCRA)--delegate a significant portion of program responsibility to the states.

Enforcement--monitoring environmental quality and emissions, inspecting facilities, levying and collecting fines, issuing notices of violation, invoking civil and criminal penalties, recalling products, and revoking permits. Most statutes give the states the principal role in enforcement, although EPA retains residual or concurrent enforcement authority. Statutes also provide for enforcement by citizen suits in the absence of corrective government actions.

Research and development--developing and providing technical guidance for standard setting, program design, and enforcement. Many of the statutes authorize EPA to conduct or fund research, to prepare technical guidance, or to report to the Congress on the progress of environmental protection. For example, the 1977 amendments to the Clean Air Act authorize research on emissions that could affect stratospheric ozone, and the 1986 Superfund Amendments and Reauthorization Act (SARA) requires a team of federal agencies to prepare an Emergency Planning Guide to be used by state and local officials in complying with SARA's emergency planning requirements.

Funding--providing funds necessary to meet administrative costs. Most state activities required by federal statutes are funded, at least in part, by federal grants.

## Air Quality Control Programs

The Clean Air Act of 1955, together with subsequent amendments, is the principal federal statute governing air pollution. Under this act, the federal government has responsibility for setting air quality standards; the responsibility for attaining these standards rests with the states. Toxic air pollution, while addressed in the CAA, has received little federal regulatory attention, but is addressed by state air programs in 20 states. In addition, both the federal government and the states conduct research on the issues of acid rain and indoor air pollution; a number of states have already initiated regulatory programs in these areas.

The Clean Air Act. The CAA and its amendments represents a unique federal-state partnership. Under this act, EPA is responsible for setting national ambient air quality standards (NAAQS) for criteria pollutants, based on health effects. NAAQS are currently in effect for six pollutants: total suspended particulates, sulfur dioxide, ozone, nitrogen oxides, carbon monoxide, and lead. EPA is also responsible for setting new source performance standards (NSPS) for stationary sources of criteria pollutants, and uniform national emissions standards for new mobile sources of criteria pollutants, and for setting national emission standards for "hazardous air pollutants" (NESHAPs).

States, through their state implementation plans (SIPs), have primary responsibility for establishing procedures by which national standards will be met for Air Quality Control Regions within each state. Each state develops a SIP that must be submitted to EPA for approval; if no approved plan exists, EPA must develop a plan. At a minimum, a SIP must include emissions standards for pre-1970 stationary sources and new cars and trucks, and must incorporate new source standards and new source review procedures. All states currently have accepted delegation of the air quality protection program. As of December 1985, 33 states had deficient plans for controlling sources and pollutant levels in one or more counties, and EPA had imposed sanctions on 21 states as a result of these deficiencies; sanctions imposed included construction bans and funding restrictions.3/ SIP enforcement is shared among EPA, states, and private citizens.

Indoor Air Pollution. Programs dealing with indoor pollution have begun to emerge in this decade in response to increasing evidence of the presence of toxic chemicals in indoor air and water supplies resulting, in part, from energy conservation measures that reduce ventilation. The pollutants currently being addressed at the state or federal levels include asbestos, radon, lead, biological contaminants, volatile organic compounds such as formaldehyde, and combustion by-products such as carbon monoxide.

Federal activity in this area has been limited primarily to monitoring and

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3. U.S. Environmental Protection Agency, *Actions on Deficient SIPs and Other Nonattainment SIPs*, in-house database printout, Office of Air and Radiation (1986), referenced in Fund for Renewable Energy and the Environment, *The State of the States: 1987* (Washington, D.C., February 1987), p. 33, Air Matrix, n.1.

research. Some federal statutes and regulations exist: federal rules restrict smoking in federal buildings and on short airplane flights; the Asbestos Hazard Emergency Response Act requires states to submit asbestos management plans covering public and private schools, and provides funds for this purpose; and the Department of Housing and Urban Development (HUD) restricts the use of formaldehyde-emitting wood products in mobile homes. In addition, EPA has established a remedial action level for radon in the home.

A recent study reports that these federal statutes, together with independent state statutes, have resulted in significant efforts to curb indoor pollution at the state and local levels. Forty-two states and more than 200 cities and counties have passed legislation that limits or prohibits smoking in public places. Eleven states offer free or subsidized testing of homes for radon, and 22 states offer educational materials; some states offer low-interest loans for home repair. States are moving to pass asbestos-related legislation: 39 states require some form of accreditation of asbestos removal contractors, and several offer educational materials.4/ One state has expanded the restrictions on formaldehyde products beyond those specified by HUD.

Toxic Air Pollution. The Clean Air Act amendments of 1970 require EPA, under the provisions governing National Emission Standards for Hazardous Air Pollutants, to set standards for pollutants that present a threat to public health. As of October 1986, EPA had regulated only seven pollutants, and expected to promulgate final standards for an additional eight pollutants in 1988. States have begun stepping into the gap left by federal regulations. As of May 1986, 17 states had air toxics regulatory programs in place, and 29 states were in the process of developing programs.5/

### Water Quality Control Programs

The two primary statutes directed at improving the quality of surface and drinking waters are the Clean Water Act of 1972 (CWA), and the Safe Drinking Water Act of 1974 (SDWA), together with subsequent amendments to these acts. Both statutes provide the federal government with substantial responsibility for setting standards; they permit delegation of program management to states, subject to EPA approval. Neither these acts nor other federal statutes contain a comprehensive program for groundwater protection, but a number of statues contain provisions that address groundwater contamination problems; in addition, many states have assumed responsibility for designing and implementing policies to deal with this pollution problem.

The Clean Water Act. The CWA has two major parts: the provisions authorizing federal support of municipal sewage treatment, and the regulatory

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4. For discussions of state activities in indoor pollution, see Fund for Renewable Energy and the Environment, *The State of the States: 1988* (Washington, D.C., February 1988).

5. General Accounting Office, *Air Pollution: States Assigned a Major Role in EPA's Air Toxics Strategy* (March 1987), pp.4, 8.

requirements designed to control industrial and municipal discharges. As in the Clean Air Act, the regulatory requirements of the CWA establish a federal-state partnership, although the CWA assigns a larger role for states in setting standards. The CWA requires EPA to issue regulations containing technology-based effluent standards applicable to categories of industrial sources. To supplement federal standards, if needed, states may set water quality standards consisting of maximum allowable concentrations of pollutants based on designated use classifications, such as recreation, water supply, or agriculture, for each body of water within the state. The principal mechanism for enforcing the water quality and effluent standards is the National Pollutants Discharge Elimination System (NPDES) permitting process. More than two-thirds of the states have been delegated the NPDES permit program.6/ In addition to the NPDES program, states may be delegated responsibility for the issuance of permits for disposing of dredge or fill material in bodies of water.

The second major portion of the CWA is the authorization of grants for construction of municipal sewage facilities. As of January 1987, 45 states had obtained authority to administer portions of the municipal wastewater treatment construction program.7/ In addition, under the 1987 amendments to the CWA, states are directed to develop and implement nonpoint pollution management programs and to undertake groundwater protection activities as part of their overall nonpoint pollution control effort. As under the CAA, enforcement responsibilities and powers are given to EPA, the states, and to private citizens.

The Safe Drinking Water Act. The SDWA has three major sets of provisions. First, the act requires EPA to issue national drinking water regulations that are based on both health effects and available technology. States are responsible for developing, implementing, and enforcing regulations at least as stringent as those set by the federal government. Most of the states have been delegated authority for this program.8/ Second, EPA is required to issue regulations governing state programs to protect underground sources of drinking water by controlling underground injection of wastes. States must submit plans to implement an underground injection control program to EPA for approval; if no approved state plan exists, EPA must implement the program. Finally, under the 1986 amendments to the act, EPA may award grants to states for developing and implementing groundwater protection programs; if states choose not to establish such programs, EPA has no authority to establish a program. The 1986 amendments also require states to ban lead in certain uses of plumbing; in response, 26 states have already banned the use of lead in drinking water systems.

Groundwater Protection. There is no single federal regulatory program to

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6. Fund for Renewable Energy and the Environment, *State of the States: 1988*, p. 47; and Congressional Research Service, *Summaries of Federal Environmental Laws*, p. 17.

7. Congressional Research Service, *Summaries of Federal Environmental Laws*, p. 17.

8. Ibid, p. 28.

protect groundwater, although EPA has established an Office of Groundwater Protection to coordinate its activities, and numerous federal programs including the Clean Water Act, the Resource Conservation and Recovery Act, and the Safe Drinking Water Act, address some aspect of the groundwater problem and require or fund state activities to protect groundwater. A majority of the states have developed or are developing groundwater protection plans and have implemented programs to assist in groundwater protection. State activities range from the development of groundwater standards and protection strategies to underground storage tank programs, agricultural contamination programs, and waste disposal programs.9/

## Hazardous and Solid Waste Management

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), known as Superfund, and the Resource Conservation and Recovery Act of 1976 (RCRA), together with subsequent amendments, provide the authority for regulations governing the disposal and cleanup of hazardous waste. RCRA, which governs disposal, permits delegation of substantial portions of the hazardous waste management program to the states; however, CERCLA retains federal control over cleanup operations.

The Resource Conservation and Recovery Act. RCRA and its amendments govern the management and disposal of solid and hazardous wastes. Subtitle C of this act creates a "cradle to grave" hazardous waste management program. The federal government is responsible for key components of this program, including identifying criteria determining whether or not wastes are hazardous and developing standards and regulations for generators and transporters of waste and for facilities that treat, store, and dispose of waste. The two major compliance mechanisms under Subtitle C are a manifest system that tracks waste from point of generation to final treatment, storage, or disposal, and requirements that permits be issued for all treatment, storage, or disposal facilities. RCRA is designed to encourage states to take over EPA's hazardous waste management program. As of June 1988, 42 states were administering all or part of the RCRA program.10/ Both EPA and states have enforcement authority under RCRA. Subtitle D of RCRA provides financial and technical assistance to states for solid waste management, resource conservation, and resource recovery; however, appropriations for assistance under this subtitle ceased in fiscal year 1981.

The Comprehensive Environmental Response, Compensation, and Liability Act. CERCLA authorizes the federal government to respond to spills and other releases of hazardous substances and to leaking hazardous waste dumps. The act establishes the Superfund, which is to be used for cleanups and is financed mostly by taxes (on crude oil, for example), general revenues, and recoveries

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9. General Accounting Office, *Groundwater Quality: State Activities to Guard Against Contaminants* (February 1988).

10. General Accounting Office, *Hazardous Waste: New Approach Needed to Manage the Resource Conservation and Recovery Act* (July 1988), p. 14.

from responsible parties. The 1984 amendments to RCRA establish a new program regulating underground storage tanks, and the 1986 amendments to CERCLA establish a Leaking Underground Storage Tank (LUST) trust fund for many cleanups not covered under Superfund.

As directed by CERCLA, EPA has assembled a National Priorities List of sites targeted for remedial action under Superfund. CERCLA does not provide for delegation of the cleanup program to states; however, states can exercise considerable control over the process by requiring cleanups to meet more stringent state standards (and providing additional funds for this purpose) or by refusing to provide state contributions to the initial cleanup and ongoing maintenance costs, which contributions are required by statute before EPA can proceed. EPA may either take the lead in cleaning up a site, or it may set up a cooperative arrangement with the state involved. Under these agreements, Superfund and the state both contribute to financing the cleanup, which is supervized by the state, although EPA retains oversight authority and responsibility. In response to delays in federal cleanup, states have begun to implement their own Superfund laws and financing mechanisms. More than half the states possess, and are actively exercising, authority to initiate remedial action.11/

Title III of the 1986 Superfund Amendments and Reauthorization Act (SARA) provides new responsibilities in the area of emergency planning for EPA and state and local governments. Title III has three major sections: emergency planning, community right-to-know reporting, and toxic chemical release reporting. Under the emergency planning provisions, state and local governments are responsible for designing and implementing emergency plans for responding to chemical accidents. EPA's role is to provide guidance and technical assistance. The community right-to-know provisions require state and local governments to maintain and make available to the general public inventory reports on quantities and types of chemicals stored at facilities in their jurisdictions. Finally, the emissions inventory provisions require EPA to establish an inventory of toxic chemical emissions from specific categories of facilities nationwide.

## RECENT TRENDS IN FUNDING RESPONSIBILITY

As shown in the previous section, both the federal government and the states have been assigned new responsibilities for environmental protection over the last two decades. In particular, states have in recent years been delegated a growing portion of program responsibility under the major air, water, and hazardous waste programs. States are also devoting resources to developing programs to address emerging problems, at the same time that the federal government is undertaking technical research and developing coordinated approaches to address these issues. These trends in program responsibility are, in part, reflected in funding trends.

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11. Fund for Renewable Energy and the Environment, *State of the States: 1987*, p. 20.

EPA expenditures on environmental protection, and the percentage of these funds going to aid state programs, have both declined over the last 12 years in real terms. EPA program expenditures and grants to states peaked in 1979, dropped sharply in 1981 and 1982, and began rising gradually in 1983. EPA's estimated total budget and contributions to states in 1989 are both significantly below their 1979 values. During the same period, grants to state programs, excluding construction grants, fell from $497 million to $270 million (in 1987 constant dollars), which is slightly more than half the 1979 value.[12] Construction grants have been steadily declining since 1979; the Water Quality Act of 1987 calls for a phase-out of federal construction grants by 1994, substituting an $8.4 billion state program of grants for revolving loan funds for localities.

Federal expenditures and state grants for waste programs have both risen in the last 10 years, as have federal contributions to the Superfund, reflecting growing program responsibilities for hazardous and solid waste management. Despite reduced air and water grants, state expenditures on air, water, and hazardous waste all have risen; between 1982 and 1986, water program expenditures rose by over 40 percent and hazardous and solid waste budgets more than doubled in real terms. Although EPA grants are still an important component in state expenditures, states are funding a growing percentage of their expenditures on these programs. In particular, estimates presented in this paper suggest that states in 1986 were responsible for 67 percent of water program costs and 60 percent of waste program costs, in comparison with 51 percent and 24 percent in 1982. The percentage of state expenditures financed by state revenues in the air program rose slightly, from 51 percent to 54 percent during this same period.

## Federal Funds

As Table 1 indicates, EPA's operating budget has declined in real terms over the last 12 years from a peak of $1.8 billion (1987 constant dollars), to $1.5 billion estimated for 1989, or by 16 percent. This decline is the result of an increase in real terms of approximately 20 percent between 1982 and 1989, after a sharp decline of almost 25 percent between 1981 and 1982. Total EPA expenditures, including construction grants and payments to Superfund and the Leaking Underground Storage Tank trust fund, are roughly the same in 1989 as they were in 1982, reflecting declines in construction grants.

The distribution of the budget by function, displayed in Table 2, has remained roughly constant over the past 12 years. Research and development outlays have been between 11 percent and 15 percent of the total budget since

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12. Throughout this section current dollars have been converted to 1987 constant dollars using the implicit price deflator for gross national product. For 1978 through 1987, the deflator is taken from *Economic Report of the President* (February 1988), Table B-3. For 1988 and 1989, CBO forecasts of the GNP deflator are used, as reported in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1989-1993, Part I* (February 1988), Table I-7.

TABLE 1. EPA BUDGET FOR ENVIRONMENTAL PROGRAMS
(In millions of 1987 dollars)

| Year | Operating Budget | Superfund | Construction Grants | LUST a/ | Total |
|---|---|---|---|---|---|
| 1978 | 1,626 | 0 | 7,329 | 0 | 8,955 |
| 1979 | 1,798 | 0 | 6,278 | 0 | 8,076 |
| 1980 | 1,738 | 0 | 4,664 | 0 | 6,402 |
| 1981 | 1,690 | 94 | 2,000 | 0 | 3,784 |
| 1982 | 1,276 | 223 | 2,820 | 0 | 4,320 |
| 1983 | 1,187 | 238 | 2,749 | 0 | 4,173 |
| 1984 | 1,215 | 447 | 2,650 | 0 | 4,312 |
| 1985 | 1,425 | 655 | 2,537 | 0 | 4,617 |
| 1986 | 1,468 | 269 | 1,827 | 0 | 3,564 |
| 1987 | 1,542 | 1,411 | 2,361 | 50 | 5,363 |
| 1988 | 1,529 | 1,091 | 2,228 | 14 | 4,862 |
| 1989 | 1,514 | 1,487 | 1,394 | 46 | 4,441 |

SOURCES: Congressional Budget Office, from data reported in Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; and Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988).

NOTE: Totals may not equal sum of components because of rounding. Data for 1978 through 1987 are actual budget authority; 1988 data are estimated budget authority; 1989 data are President's requested budget authority.

a. Leaking Underground Storage Tank trust fund.

TABLE 2. EPA OPERATING BUDGET BY FUNCTION
(In millions of 1987 dollars)

| Year | Salaries and Expenses | Research and Development | Abatement, Control, and Compliance | Buildings and Facilities | Total |
|---|---|---|---|---|---|
| 1980 | 720 | 320 | 695 | 3 | 1,738 |
| 1981 | 703 | 314 | 669 | 5 | 1,690 |
| 1982 | 652 | 181 | 438 | 4 | 1,276 |
| 1983 | 628 | 137 | 417 | 3 | 1,187 |
| 1984 | 630 | 152 | 430 | 3 | 1,215 |
| 1985 | 704 | 200 | 507 | 13 | 1,425 |
| 1986 | 678 | 217 | 569 | 5 | 1,468 |
| 1987 | 727 | 198 | 610 | 8 | 1,542 |
| 1988 | 740 | 180 | 586 | 23 | 1,529 |
| 1989 | 743 | 183 | 580 | 7 | 1,514 |

SOURCES: Congressional Budget Office, from data reported in U.S. Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; and Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988).

NOTE: Totals may not equal sum of components because of rounding. Data for 1980 through 1987 are actual budget authority; 1988 data are estimated budget authority; 1989 data are President's requested budget authority.

1982, and were about 18 percent of the total budget in 1980 and 1981. Abatement, control, and compliance expenditures (as a percentage of the total budget) fell to 34 percent in 1982, grew gradually to 40 percent in 1987, and leveled off at 38 percent in 1988 and 1989.

The operating budgets for air, water, and hazardous waste together constituted approximately 55 percent to 60 percent of the EPA annual operating budget between 1978 and 1989. As illustrated in Table 3, the programs for air, water, and hazardous and solid waste were all sharply cut back in real tersm in 1982; the air budget fell the least (16 percent), water fell by 28 percent, and hazardous waste showed the sharpest decline (34 percent). In 1983, air and water programs were almost 40 percent and 48 percent, respectively, below their 1979 peaks. The air program budget fell from $401 million in 1979 to $243 million in 1983, while water funding dropped from a peak of $602 million to $318 million in 1983. Although air and water program funding tended to grow between 1983 and 1987, the 1989 estimated budgets for these programs are still well below the 1979 peaks, by 40 percent for the air program and 43 percent for the water program. Hazardous and solid waste spending rose sharply in 1981, following the passage of the Comprehensive Environmental Response, Compensation, and Liability Act in 1980, and has more than doubled since 1982, following amendments to CERCLA and the Resource Conservation and Recovery Act.

Table 3 also displays the portion of EPA's operating budget that is devoted to grants to state governments. Grants to states for air, water, and hazardous waste account for over 94 percent of all state environmental grants. Overall, grants for the three major programs combined fell in real terms from $477 million to $251 million between 1979 and 1983--a decline of 47 percent. Between 1983 and 1987, major media grants rose by about 15 percent, to $289 million. On balance, the state grant budget for these three program areas combined has fallen from its peak in 1979 by almost 50 percent, to $256 million. Hazardous waste state program funding is approximately the same in 1989 as it was in 1979--$70 million. The decline in state grant funding is, thus, due primarily to declines in the air and water programs. Air and water grants in 1989 are $88 million and $98 million, respectively--less than half of their 1979 peaks, and approximately 15 percent lower than their levels in 1982. Hazardous waste grants are about 40 percent higher than in the first three years of this decade.

As a percentage of EPA's operating budget, state grants are below their 1979 peaks, and have steadily declined since 1982, as shown in Table 4. The largest decline has occurred in the hazardous waste program, which accounts for only 29 percent of EPA's budget in 1989, compared with 39 percent in 1982. The proportion of federal funds going to states for water and air programs also declined slightly between 1982 and 1989, from 31 percent to 28 percent for water and from 40 percent to 37 percent for air.

## State Expenditures

While federal grants to states declined between 1982 and 1986 for the three major program areas (with the exception of waste), total state environmental

TABLE 3. EPA OPERATING BUDGET FOR ENVIRONMENTAL PROGRAMS (In millions of 1987 dollars)

| | Operating Budget | | | | | Grants to States | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | Air | Water a/ | Hazardous Waste b/ | Subtotal c/ | All Programs | Air | Water a/ | Hazardous Waste b/ | Subtotal c/ | All Programs d/ |
| 1978 | 280 | 599 | 58 | 937 | 1,626 | 108 | 253 | 23 | 384 | 396 |
| 1979 | 401 | 602 | 110 | 1,113 | 1,798 | 194 | 216 | 67 | 477 | 497 |
| 1980 | 340 | 561 | 131 | 1,031 | 1,738 | 114 | 187 | 53 | 353 | 370 |
| 1981 | 306 | 521 | 189 | 1,016 | 1,690 | 110 | 167 | 48 | 324 | 339 |
| 1982 | 256 | 373 | 125 | 754 | 1,276 | 103 | 115 | 49 | 267 | 281 |
| 1983 | 243 | 318 | 136 | 697 | 1,187 | 96 | 105 | 50 | 251 | 264 |
| 1984 | 245 | 322 | 140 | 707 | 1,215 | 96 | 104 | 51 | 251 | 264 |
| 1985 | 248 | 357 | 203 | 809 | 1,425 | 96 | 111 | 60 | 267 | 282 |
| 1986 | 253 | 340 | 241 | 834 | 1,468 | 99 | 109 | 68 | 276 | 290 |
| 1987 | 247 | 370 | 255 | 872 | 1,542 | 95 | 122 | 72 | 289 | 302 |
| 1988 | 238 | 357 | 251 | 845 | 1,529 | 90 | 105 | 69 | 264 | 279 |
| 1989 | 239 | 343 | 343 | 825 | 1,514 | 88 | 98 | 70 | 256 | 270 |

SOURCES: Congressional Budget Office, from data reported in U.S. Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; and Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988).

NOTE: Totals may not equal sum of components because of rounding. Data for 1978 through 1987 are actual budget authority; 1988 data are estimated budget authority; 1989 data are President's requested budget authority.

a. Includes both water quality and drinking water programs.
b. Includes both hazardous and solid waste programs.
c. Subtotal for air, water, and hazardous waste.
d. Includes grants for pesticides and toxic substances; does not include construction grants.

## TABLE 4. GRANTS TO STATES AS PERCENTAGES OF EPA OPERATING BUDGET, BY PROGRAM

| Year | Air | Water a/ | Hazardous Waste b/ | Other | Total |
|---|---|---|---|---|---|
| 1978 | 38 | 42 | 40 | 2 | 24 |
| 1979 | 48 | 36 | 61 | 3 | 28 |
| 1980 | 33 | 33 | 40 | 2 | 21 |
| 1981 | 36 | 32 | 26 | 2 | 20 |
| 1982 | 40 | 31 | 39 | 3 | 22 |
| 1983 | 40 | 33 | 37 | 3 | 22 |
| 1984 | 39 | 33 | 37 | 2 | 22 |
| 1985 | 39 | 31 | 30 | 2 | 20 |
| 1986 | 39 | 32 | 28 | 2 | 20 |
| 1987 | 38 | 33 | 28 | 2 | 20 |
| 1988 | 38 | 30 | 27 | 2 | 18 |
| 1989 | 37 | 28 | 29 | 2 | 18 |

SOURCES: Congressional Budget Office, from data reported in Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; and Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988).

a. Includes both water quality and drinking water programs.

b. Includes both hazardous and solid waste programs.

budgets in these areas rose, with states contributing a growing portion of total expenditures in all three programs. Estimated total state budgets for air programs remained roughly constant in real terms between 1982 and 1986 at $200 million; however, state water program expenditures rose by over 40 percent to $336 million, and waste budgets, totalling $169 million in 1986, were more than double 1982 levels (see Table 5).13/

A clear pattern in state funding of environmental programs emerges in Table 6. Although federal grants to all three state programs either did not fall dramatically or else rose between 1982 and 1986, the percentages of state program budgets supported by federal grants have declined over time. The trend is most noticeable in hazardous waste management, although small declines are also evident in the air and water programs. In particular, between 1982 and 1986, federal support for state air programs fell from 49 percent to 46 percent. Federal grants in 1982 constituted nearly half of state water program budgets; in 1986 only one-third of those budgets came from EPA grants. For waste programs, the change has been dramatic: despite the growth in EPA grants for waste programs, the percentage of state waste program budgets funded by federal grants fell from 76 percent in 1982 to only 40 percent in 1986.

A survey of state officials conducted jointly by several national associations presents another picture of federal funding support, which tends to support the results in Table 6.14/ According to this report, federal grants for fiscal year 1982 funded 45 percent of state air program budgets, about 46 percent of state water quality program budgets, about 69 percent of state hazardous waste program budgets, and about 48 percent of state drinking water supply program budgets.

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13. The total state water and waste budgets for states presented in Table 5, and used to compute Table 6, were obtained from an informal telephone survey of state environmental officials performed by the Congressional Budget Office between March 1987 and July 1988, and thus should be treated as estimates. The total state air budget figures, as noted on Table 5, were obtained from a survey of state agencies by the State and Territorial Air Pollution Program Administrators (STAPPA). In the context of this paper, several features of both the CBO data and the STAPPA survey deserve note. In particular, the state budget estimates may include grants from federal agencies other than EPA; they may not include budgets for all programs (since related programs may be implemented by multiple agencies within a state); and they may not include grant money passed through to local governments. In addition, several states did not report to CBO for all years, and some states may have reported data by calendar year, although fiscal year was requested.

14. Thomas W. Curtis and Peter Creedon, National Governors' Association Committee on Energy and Environment, *The State of the States: Management of Environmental Programs in the 1980s* (Washington, D.C., June 1982).

TABLE 5. TOTAL STATE BUDGETS FOR AIR, WATER, AND HAZARDOUS WASTE PROGRAMS (In millions of 1987 dollars)

| Year | Air | Water a/ | Hazardous Waste b/ | Total |
|---|---|---|---|---|
| 1982 | 210 | 236 | 64 | 510 |
| 1983 | 213 | 274 | 76 | 563 |
| 1984 | 206 | 296 | 110 | 613 |
| 1985 | 202 | 326 | 146 | 675 |
| 1986 | 213 | 336 | 169 | 717 |

SOURCES: Congressional Budget Office, from Congressional Budget Office survey of state water and hazardous waste budgets; from state air budget data reported in State and Territorial Air Pollution Program Administrators and the Association of Local Air Pollution Control Officials, *Air Permit and Emissions Fees: Results of a Survey*, prepared by Mary M. Sullivan (Washington, D.C., April 1987); and from unpublished additional state air budget survey data provided by the State and Territorial Air Pollution Program Administrators.

NOTE: Details may not sum to totals because of rounding.

a. Includes water quality programs; some drinking water programs may not be included.

b. Includes both hazardous and solid waste programs.

TABLE 6. GRANTS TO STATES AS A PERCENTAGE OF TOTAL STATE BUDGETS, BY PROGRAM

| Year | Air | Water a/ | Hazardous Waste b/ |
|---|---|---|---|
| 1982 | 49 | 49 | 76 |
| 1983 | 45 | 38 | 66 |
| 1984 | 46 | 35 | 47 |
| 1985 | 48 | 34 | 41 |
| 1986 | 46 | 33 | 40 |

SOURCES: Congressional Budget Office, from Congressional Budget Office survey of state water and hazardous waste budgets; from federal grant data reported in Environmental Protection Agency, *Justification of Appropriation Estimates for Committee on Appropriations*, for fiscal years 1980, 1981, 1982, 1984, and 1989; Environment and Energy Study Conference, *Senate Floor Brief* (Washington, D.C., June 18, 1984) and *Special Report* (Washington, D.C., February 24, 1988); from state air budget data reported in State and Territorial Air Pollution Program Administrators and the Association of Local Air Pollution Control Officials, *Air Permit and Emissions Fees: Results of a Survey*, prepared by Mary M. Sullivan (Washington, D.C., April 1987); and from unpublished additional state air budget survey data provided by the State and Territorial Air Pollution Program Administrators.

a. Includes water quality programs; some drinking water programs may not be included.

b. Includes both hazardous and solid waste programs.

## AN EVOLVING PARTNERSHIP

As discussed in preceding sections, the partnerships under which federal, state and local governments participate in the management of air and water quality and hazardous waste have altered during recent decades. Both federal and state governments have new responsibilities, and a growing portion of responsibility for existing pollution control programs has devolved to the states; states are the principal agents responsible for certification and issuing permits, and often have primary responsibility for devising and enforcing control programs designed to meet statutory goals and federal standards. The federal government maintains a strong role in overseeing, enforcing, and providing technical guidance to assist state implementation of these programs, and continues to provide financial support for research and development. States are also taking the initiative in developing protection programs side by side with federal efforts to cope with emerging environmental concerns, such as groundwater contamination and toxic air pollution.

In part, the trends in fiscal responsibility during the last six to ten years reflect and in part contrast with, this movement in program responsibility. EPA's operating budget is lower in real terms than last 10 years ago, although it has been increasing in recent years. The overall declines have occurred primarily in the mature air and water quality control programs; in contrast, the hazardous waste budget has risen steadily, reflecting expanding federal requirements for waste management. Fiscal responsibility has been shifting to the states; EPA grants to state and local governments have declined over the past 10 years in real terms, both for air and water quality control programs and overall; in all programs, grants are a declining or constant percentage of EPA's budget. Despite declines in grants, state budgets appear to be rising, and states are funding a growing percentage of their program expenditures.

# CHAPTER III

# ALLOCATING GOVERNMENTAL RESPONSIBILITY FOR ENVIRONMENTAL PROTECTION

A number of factors may determine what level of government ought to be responsible for a specific environmental program. These include, among others, the geographic dispersion of pollutants, the type and amount of information needed to design and run a program, and the cost structure of alternative control strategies. At the same time, the particular level of government chosen may affect the kind of control program selected, the level of environmental protection that ultimately occurs, and who gains or loses from the program. All of these considerations may enter into choosing a division of responsibility that will best promote desirable environmental policies. This section approaches the problem from an economist's point of view--that is, it evaluates governmental intervention in environmental policy in terms of its impacts on economic efficiency and equity.1/

## THE NOTIONS OF ECONOMIC EFFICIENCY AND ECONOMIC EQUITY

Efficiency and equity provide two quite different perspectives on public policies: economic efficiency speaks to the magnitude and relationship of benefits and costs, while equity is concerned with the distribution of costs and benefits. Together, they can be used to create a broad economic framework for assigning responsibilities among various levels of government.

### Economic Efficiency

From an efficiency perspective, a desirable allocation of responsibilities is one that promotes:2/

- Environmental programs that result in a balance between marginal

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1. An economic perspective is adopted here because of concerns over budget impacts and the allocation of resources. Other criteria may also be used to evaluate environmental programs and governmental roles, such as health and ecological standards, constitutionality, and personal and states' rights.

2. In the absence of government intervention, society will not provide an efficient level of environmental protection. See, for example, William J. Baumol and Wallace E. Oates, *The Theory of Environmental Policy*, Second Edition (Cambridge: Cambridge University Press, 1988).

costs and marginal benefits;3/

- o Environmental programs that result in the lowest level of costs for a given level of benefits; and
- o Environmental programs that ensure the greatest benefits for a given level of costs, that is, with the resulting benefits going to those who value them the most.

From the standpoint of economic efficiency, governmental responsibilities should be allocated to allow environmental policies that provide the maximum level of benefits for a given level of expenditure; no other allocation provides more benefits at the same or lower level of costs to society.

## Economic Equity

The concept of equity relates not so much to the level of benefits and costs as to how they are distributed among individuals and over time. The equity criteria stresses the notion of fairness as an important value to be used in conjunction with the more formal calculation of efficiency. This is not to suggest that efficiency goals are value free, but rather that economic efficiency does not concern itself with judgments concerning who bears the costs of programs and who benefits.4/

In the context of the allocation of environmental program responsibilities, a scheme may be judged inequitable or unfair if, for example:

- o The costs of a control program are not borne by those responsible for the pollution;
- o The costs of a control program are imposed on a particular group disproportionately to its ability to meet the burden; or
- o The benefits of the program are unevenly distributed.

Equity is not concerned simply with the distribution of costs and benefits at one point in time, but also with their distribution over time. Thus, an allocation that does not adequately reflect the interests of future generations for a cleaner environment may be held inequitable.

When economic efficiency and equity are used as guides in deciding how to

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3. Economic theory suggests that an efficient control program reduces pollution to the point at which the cost of further reductions equals the benefit of the reduction.

4. The measure of efficiency, for example, assumes a given distribution of wealth and income in the population. Redistributing income would revise the efficiency properties of alternative environmental programs by changing the costs and benefits associated with each level of pollution control.

allocate governmental responsibilities for environmental protection, they can lead to very different solutions depending on which weighs more heavily. A solution that makes sense in terms of balancing costs and benefits may violate a particular notion of fairness. While economic analysis does not offer much assistance in weighing efficiency and equity concerns, it provides a framework for identifying decisions in which tension is most likely to occur (see Box 2).

## RESOURCE ALLOCATION AND GOVERNMENTAL RESPONSIBILITY

From an economic efficiency perspective, the appropriate level of government to deal with an environmental problem is the level that is best able to assess costs and benefits accurately. Levels of government vary in their abilities to do this, depending on the activities involved. Smaller units of government tend to be closer to the environmental problem and the persons and firms affected. They may have better information on local circumstances, and thus be able to assess costs and benefits more accurately and provide programs that address specific local problems and circumstances. Smaller units of government may also have an advantage in terms of flexibility and the ability to provide more innovative solutions to environmental problems.

On the other hand, small governmental units can be at a disadvantage when there are substantial externalities, information requirements, or economies of scale. For example, if a large number of the persons and firms receiving benefits or incurring costs under a program are located outside the boundary of the jurisdiction, then it is less likely that local government will take into account the preferences of these groups and accurately assess the real costs and benefits. In addition, some program activities--such as setting health or technology-based standards--require substantial amounts of technical information. Small governmental units may not be willing or able to incur the costs of developing or acquiring this information. Also, economies of scale may exist, as in issuing permits or building wastewater treatment plants. If so, then larger governmental units may be better able to achieve these economies and provide lower-cost services. Allocating responsibility to a more centralized level of government may also be preferred if uniform treatment of individuals, polluters, or municipalities is desirable from an efficiency or equity viewpoint.

An equity perspective offers fewer analytical (or measurable) guidelines for selecting the appropriate level of government than does the efficiency perspective. From an equity standpoint, the key question is what level of government is best able to assess various social preferences for fairness. On the one hand, it might seem a reasonable presumption that lower levels of government are likely to be more responsive to the impacts of environmental programs on the distribution of costs and benefits within their own jurisdictions. As the impacts of programs expand, higher governmental entities may become more appropriate, because they include more of the affected population. On the other hand, it might be argued that lower levels of government are more susceptible to pressures from those seeking economic growth or development without regard to fairness. Also, it is not clear which levels of government are more likely to represent the desires of future generations, particularly in a

## BOX 2
## Evaluating Trade-offs: The Regulatory Flexibility Act

Federal environmental statutes allocate broad responsibility for environmental protection activities across levels of government. Within this framework, federal agencies have leeway in the magnitude and nature of the requirements imposed on lower levels of government. The concepts of efficiency and equity can guide both statutory assignments of responsibility and the design of regulations; both statute and regulations should attempt to provide environmental protection programs that not only achieve benefits at the lowest cost to society but also embody notions of equity.

In large part, these principles are reflected in the contents of the Regulatory Flexibility Act of 1980 (RFA), which requires that regulatory agencies consider ways to reduce the regulatory burden on entities such as small businesses, small organizations, and small cities and towns. The RFA requires that, in promulgating regulations, an agency must demonstrate that it has considered alternatives that reduce the impact on small governments and businesses by employing features such as exemptions, different or simpler compliance and reporting requirements, and performance rather than design standards.

The discussion in the act in support of the requirement to reduce the burden on small entities is consistent with the principles outlined in Chapter III of this paper. The basic economic criterion for allocating responsibility is that costs imposed by regulation should reflect benefits to society. Uniform requirements do not necessarily mean that burdens imposed are uniform. In particular, since small entities may have fewer and less versatile resources than large entities and may not be able to take advantage of economies of scale, burdens may fall more heavily on smaller entities. To the extent that options are available to reduce the economic impact on small entities without a significant loss of regulatory benefits, agencies should exercise these options.

The rationale underlying the act is also supported by notions of equity. If burdens are imposed that fall unequally on businesses or jurisdictions, or that exceed ability to pay, equity considerations may suggest providing additional funding. Thus, efficiency considerations suggest matching the benefits and costs, while equity suggests matching the burden to the capacity to pay; together they suggest that regulatory requirements be matched to the scale of the regulated entity.

Although the act stresses the importance of efficiency and equity, it does not provide guidelines for agencies to use in choosing between them. Both efficiency and different notions of equity may argue for national standards that are implemented by state and local governments. Complying with national requirements may result in significant costs. How crucial is it in developing national policies to consider the burden these costs impose? On the one hand, the responsibility and burden of environmental improvement should be allocated to achieve appropriate levels of environmental protection. On the other hand, the burden may be substantial. While the act provides an impetus for regulatory agencies to adopt innovative procedures to prevent small entities from being unnecessarily affected by regulations, it does not suggest how these concerns should be weighed against the stated goals of the statute.

mobile society.5/

Efficiency and equity taken together might suggest that the appropriate level of government is one that can acquire information cheaply on who the gainers and losers from environmental policy are, and how great their gains and losses are. It would be crucial, however, that the information be reflected in political decisions; that is, the government must be capable of acting to promote efficient and equitable policies and programs. This would depend on how political decisions are made in the jurisdiction, on the characteristics of the jurisdiction and its population, and on the environmental problem involved. Smaller governmental units may act more effectively if all benefits and costs are encompassed by the jurisdiction, if the population is relatively homogeneous in tastes, and if the environmental problem is pervasive enough to be of major concern to the community. Alternatively, small governmental units may be less able to resist group pressures to attract or keep industry by reducing environmental standards.

## SOME ECONOMIC CRITERIA

The following paragraphs expand on several of the criteria that may help to guide environmental federalism decisions from the standpoint of efficiency. Specific equity issues are discussed more extensively farther on as they relate to nationally uniform standards and to the level of government that should be responsible for funding programs.

### Flexibility in Environmental Protection

Because local preferences and local circumstances vary, a single standard of environmental quality may not be appropriate for all jurisdictions. The same is true for program administration. Smaller units of government may have an advantage over larger ones in designing environmental protection programs to deal with local problems.

Standards and programs promoted by larger units of government tend to be uniform, rather than tailored to conditions in local units. Although the federal government can set standards that vary among and within states, such a policy is likely to be technically (and perhaps politically) infeasible except for narrowly defined areas that require special treatment, such as pristine areas or nonattainment areas. The efficiency losses from uniform national standards depend on how costs and benefits differ among localities. An efficient level of protection will not be the same everywhere, to the extent that localities vary in the amounts and types of pollution, in the damages done by the pollution, in the number of inhabitants and their preferences for pollution abatement, and in

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5. Wallace E. Oates and Robert M. Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?" *Journal of Public Economics*, forthcoming.

geographical and meteorological characteristics.6/

For example, if a community has a strong preference for environmental improvement, the local government can enforce stringent environmental standards. In another community, where environmental cleanup may be relatively expensive because pollution is high, factories are old, or geographical and climatic conditions impose difficulties, the government may choose to enact a different standard of environmental quality, or a different type of standard, in order to retain jobs and prevent industry from leaving. To impose a compromise uniform standard on both jurisdictions might force the second jurisdiction to clean up too much, or spend more than necessary. The more widely benefits or abatement costs vary among jurisdictions, the more inefficient national standards will be.

A local jurisdiction may have easier access to information on environmental tastes, protection costs, and other local circumstances than higher levels of government. Even if a larger unit of government was willing to enact standards or design programs that varied across local government units, there would be no assurance that these standards and programs would adequately suit the needs of local areas. Local governments are closer to local problems and, therefore, can more easily develop cost-effective options for dealing with local circumstances. A good example of this problem is the current effort to bring various areas of the country into compliance with the national ambient air-quality standard for ozone. Because regions vary widely in terms of their ozone problem, its development, and their prospects for controlling it, no single set of control measures is likely to be best for every area. In addition, competition between governments may also make them more innovative in policy and responsive to local needs; to the extent that it does, decentralization may enable governments to achieve a given level of environmental protection at lower cost.

As a final point, smaller units of government, as compared with the national government, may have fewer administrative and legal constraints. Thus they may be able to implement regulations more quickly, or to take advantage more easily of innovative tools and policies. For example, more than 40 states have some sort of environmental fee or charge associated with their state environmental programs. The federal government, on the other hand, still relies mainly on general revenues to fund its programs.

While flexibility and variation in standards, tools, and programs may be desirable from an efficiency perspective, equity concerns may argue against decentralization. In particular, uniform national standards do provide a minimum standard of health for everyone--not only people living in an area, but those passing through it as well. Equity concerns may dictate that, even in those situations in which efficiency would suggest variations in environmental quality, individuals have a right not to be exposed to more than a minimum level of risk.

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6. D. Ewringmann and K.H. Hansmeyer, "The Institutional Setting of Regional Environmental Policy," and Rene L. Frey, "Interregional Welfare Comparisons and Environmental Policy", both in Horst Siebert and others, eds., *Regional Environmental Policy: the Economic Issues* (New York: New York University Press, 1979).

This particular issue is discussed more fully later in this chapter.

## Spillover Benefits and Costs

While some environmental issues, such as sewage treatment, are fairly local in impact, many pollution abatement issues involve substantial externalities (spillovers) either of benefits or of costs. Pollution travels downstream, or is airborne, or otherwise affects individuals and firms located outside the immediate jurisdiction where the polluters are situated. Similarly, cost spillovers occur if the polluter provides jobs, services, or goods for persons and firms located outside the jurisdiction.

Decentralized responsibility for environmental protection is more likely to be efficient if it is possible to encompass external costs and benefits using existing political boundaries. If a governmental unit does not represent all those experiencing benefits or incurring costs, it is not likely to have complete information on costs and benefits or to have an incentive to take all costs and benefits into account in evaluating alternative environmental protection programs. Externalities that are left outstanding are difficult to capture by interjurisdictional bargaining or compacts.

One example is a situation in which pollutants are discharged into a waterway and adversely affect downstream users. In choosing to regulate, the governmental unit with jurisdiction over the polluters would take into account primarily the damages done to members of the community. Health and other costs of environmental degradation would be underestimated and environmental standards would be too low. Another example is a community that receives all the benefits of the pollution policy but does not include all the employees of the polluting firm. In its concern for the environment, the community may not take into account the true costs of pollution abatement and may regulate the polluter at the expense of the employees.

In principle, all externalities could be captured if each environmental situation was handled by a jurisdiction in which everyone who received the benefits of an improvement also incurred the costs of achieving it. Such a situation has been termed a "perfect correspondence."7/ How large a jurisdiction would need to be to achieve a perfect correspondence depends on the situation. In some instances, the appropriate unit of government may be very small. An example is a factory that provides jobs for a local community and emits air pollutants that remain in a confined area around the factory. Reducing emissions will affect people living and traveling in the area around the factory, so that benefits will accrue primarily to the community. The costs of reducing emissions consist of governmental administrative costs together with increased costs to the factory, which will be reflected largely in reduced wages or employment and in higher prices. Costs and benefits for people outside the

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7. For discussions of the efficiency properties of a perfect correspondence, see Wallace E. Oates, *Fiscal Federalism* (New York: Harcourt Brace Jovanovich, Inc., 1972) and Richard W. Tresch, *Public Finance: a Normative Theory* (Plano, Texas: Business Publications, Inc., 1981).

community will be small. In this situation, the local community can choose a level of pollution that balances the costs and benefits of improvement, since almost all costs and benefits accrue to people in the community.

Few pollution problems are confined to local political boundaries. Although some hazardous waste management may be an exception, most air and water pollution concerns go beyond one city's or municipality's lines. For these cases, a state, national, or international jurisdiction may be necessary to internalize all the costs and benefits of an environmental pollution problem. Acid rain is a case that transcends not only local and state, but regional and national boundaries as well. Much of the costs of a program to reduce sulfur dioxide emissions that contribute to acid rain problems would be borne by the high-sulfur coal-producing states in the Midwest.8/ In this case, allowing state governments, or even regional compacts of states, to regulate environmental quality would provide too little environmental protection. On the other hand, standards set at the national level to control acid rain could be regarded as inequitable, because of the diverse distributions of benefits and costs under the program. If so, for reasons of equity and in order to make controls politically more feasible, environmental regulation could be combined with a program that compensates Midwestern states for the costs of pollution control.

### Information Provision

Externalities also arise in the provision of information. The research and development necessary to set standards and design systems have benefits that extend beyond the environmental situation being analyzed or the system being designed. Information on risk assessment or on containment of hazardous spills, for example, potentially benefits all jurisdictions involved in developing emergency response programs. Local jurisdictions do not have an incentive to do all the research necessary to design such systems, since they do not reap all the benefits. Thus, some centralization of information collection may be necessary to ensure that appropriate systems are designed and implemented.

An efficient solution is more likely on a local level if information requirements are not great. The more uncertainties exist in estimating the magnitude of health or output effects, or the impact on the ecology, or the persistence of environmental effects into the future, the less likely are local or state jurisdictions to have the technical expertise necessary to make informed decisions. The role of the national government may change over time, however, as more expertise becomes available to state and local governments and they develop the technical capacity to implement and manage environmental programs.

### Economies of Scale

The provision of environmental protection often involves economies (or diseconomies) of scale. If there are economies of scale, a higher level of government can achieve cost savings by combining administrative or other

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8. Congressional Budget Office, *Curbing Acid Rain: Cost, Budget, and Coal-Market Effects* (June 1986).

functions across local jurisdictions. If centralization extends to the setting of standards as well as to administrative functions, a more uniform level of environmental quality can be achieved among jurisdictions. Alternatively, there may be diseconomies of scale. For example, the costs of decision making increase with the size of an organization, although there will be fewer organizations making decisions.

Economies of scale may also arise in connection with the costs to industry and government of complying with regulations. Decentralization leads to many diverse plans. Requiring a firm that operates in several jurisdictions to become acquainted with several sets of regulations, forms, and standards leads to higher costs of compliance. National programs create stability, and may reduce the costs of compliance by providing more uniformity and certainty in pollution control and by permitting industry to centralize compliance activities. Technical economies of scale also arise in abatement practices, such as waste treatment, recycling, and hazardous waste disposal. To the extent that larger jurisdictions permit more centralized treatment and control, a more cost-effective solution may result.

## Government Decision Making and Environmental Protection

The discussion thus far has concentrated on the level of government that is best suited to developing an environmental program that balances costs and benefits, based on the magnitude of externalities, economies of scale, and other circumstances. Levels of government also differ in the extent to which they actually incorporate costs and benefits into policy development.

Small and large jurisdictions face different problems in defining solutions to environmental problems. Small jurisdictions are unlikely to implement appropriate programs when the political process does not include those affected by externalities. Very large jurisdictions may not decide on correct environmental programs if only a small subset of a population is affected by a problem. Very large jurisdictions may also be less likely to face pressures to compete with other jurisdictions in attracting industry.

Some problems are common to small and large governments. For both, political decisions are influenced by voter preferences and by the preferences of decisionmakers, which are not always identical. In addition, the political process in large and small jurisdictions tends to favor the preferences of the representative voter, which do not necessarily coincide with the level of protection that would balance benefits and costs.

Dealing with Externalities and Internalities. If the level of government with jurisdiction over an environmental problem is too small to capture substantially all of the externalities, then the level of environmental protection will likely be inefficient. Alternatively, if the government jurisdiction includes more than those experiencing benefits and costs--sometimes called an "internality"--the environmental policy chosen is not likely to be correct.9/ For example, if the number of voters benefiting from the program exceeds the number indifferent to the program, but all or most of the voters pay the costs, a majority vote is likely to favor a program in which the costs exceed the benefits--unless complex forms of bargaining occur. Likewise, when voters are grouped into political jurisdictions whose boundaries do not match those of the environmental issues, bargaining is essential to an efficient solution.10/ If the problem is relegated to a higher level of government that captures the externality, then solutions may fail because the problems are too small relative to the scope of the higher government to get the attention they deserve.

Competition for Industry. It has been argued that state or local government officials, in a quest to attract or retain industry and jobs, will permit excessive environmental degradation; hence, the appropriate level of government may be national.11/ Competition may bias the outcome in two ways. First, in a community where workers and industry are not completely mobile, industry may be able to wield excessive power. Workers cannot cheaply or easily relocate to find other jobs and the community cannot quickly attract alternative industry and jobs. Officials may prefer to retain industry by forgoing a standard of environmental protection that would be optimal in the long run but lead, in the short run, to lost jobs, or a threat of lost jobs.

Second, a jurisdiction may overestimate the costs of pollution abatement if costs are viewed as including not only lost jobs and salaries, but also tax revenues forgone.12/ Here again, overestimating costs will lead to too little environmental protection. Interjurisdictional competition for industry is more likely if the concentration of industry and income varies widely among jurisdictions.

Conflict of Preferences. The political process is such that there may be a discrepancy between the level of pollution acceptable to voters and the level chosen by the government of a jurisdiction. Decisions made by government officials may reflect not only a desire to be reelected, but other goals such as

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9. Mancur Olson, "Strategic Theory and its Applications," *American Economic Review*, vol. 59 (1969), pp. 479-487.

10. Dennis C. Mueller, "Public Choice and Environmental Protection," Working Paper, Department of Economics, University of Maryland (1988).

11. See, for example, John H. Cumberland, "Efficiency and Equity in Interregional Environmental Management," *The Review of Regional Studies*, vol. 10 (1980), pp. 1-9, David C. Nice, *Federalism: the Politics of Intergovernmental Relations* (New York: St. Martin's Press, Inc., 1987), and Robert E. Manley, "Federalism and Management of the Environment," *The Urban Lawyer*, vol. 19 (1987), pp. 661-681.

12. Oates and Schwab, "Economic Competition."

the enhancement of salaries, status, and other perquisites of public office.13/ If so, the level of protection may not reflect the preferences of the representative voter, even when the latter coincide with the efficient solution.14/ Similarly, government is increasingly dominated by professionals, which may have resulted in a shift of influence from the private sector to government officials themselves. This suggests that the preferences of officials may in some instances dominate those of voters and special interest groups.15/

Demographic Factors. Finally, the more homogeneous the population of the jurisdiction is in its desire for environmental improvement, the more likely it is that government decision making will appropriately balance costs and benefits in reaching a decision. The political process (in particular, majority rule) tends to reflect the preferences of the representative voter. If the population is relatively uniform in income and in other demographic variables affecting tastes for a cleaner environment, and if the population is exposed uniformly to the environmental problem, then the preferences of the representative voter may reasonably be expected to reflect the benefits of environmental improvement. Conversely, if the population is heterogeneous, then majority rule decisionmaking may not appropriately reflect benefits and costs. The one-man one-vote process fails to distinguish between those who value pollution abatement highly, those who are indifferent to it, those who bear the greatest burden of abatement costs, and those who pay slightly or not at all. Thus, majority rule cannot reflect accurately the magnitude as well as the direction of voters' preferences. In that case, majority rule may not lead to the appropriate level of pollution.16/

The foregoing arguments suggest that, even if governmental responsibility is allocated in such a way as to take into account the presence of externalities and economies of scale, constraints in the political process may not result in environmental protection programs that appropriately balance all costs and benefits. Thus, the potential gains in flexibility and responsiveness implied by decentralization may not be realized. When the population is fairly homogeneous, or when the opportunities for interjurisdictional competition are minimal, an efficient outcome is more likely. But the political process may impose obstacles even if responsibility is delegated to more centralized government units, although a centralized government may have more technical expertise or bring a broader perspective to bear.

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13. H. Van Den Doel, *Democracy and Welfare Economics* (Boston: Cambridge University Press, 1979) and William A. Niskanen, *Bureaucracy and Representative Government* (Chicago: Aldine, 1977).

14. Oates and Schwab, "Economic Competition."

15. Samuel H. Beer, "A Political Scientist's View of Fiscal Federalism," in Wallace E. Oates, ed., *The Political Economy of Fiscal Federalism* (Lexington, MA: Lexington Books, 1977).

16. Oates and Schwab, "Economic Competition."

## RESPONSIBILITIES FOR SPECIFIC PROGRAM ACTIVITIES

Environmental programs comprise, as discussed earlier, a number of distinct activities that range from setting standards to enforcement. In addition, each program function requires multiple actions--for example, standard setting in water quality control may require setting concentration levels for bodies of water and also setting effluent limitations for individual polluters. It is not surprising, therefore, that the appropriate level of government to undertake each different action may vary, depending on the function involved and the nature of the environmental problem at hand. The purpose of this section is to relate some of the key considerations outlined above to determining which level of government is best for a specific activity. Part three of this study will examine these issues in more detail.

### Setting Goals and Standards

One of the major controversies in environmental protection concerns whether to set national uniform standards or to permit local variation in standards.17/ Essentially, this is a question of how decentralized the standard setting should be, and involves both efficiency and equity considerations.18/ On the one hand, there are efficiency arguments in favor of decentralizing the setting of standards: since the benefits and costs of reducing pollution vary among jurisdictions, local governments may be in a better position to recognize and act on such differences in setting standards. On the other hand, information about the health effects associated with specific exposure levels, about the technological feasibility of various emission standards, or on the relationship between ambient and emissions standards, is both expensive to obtain and subject to externalities; this argues for national standard setting. Notions of equity and altruism in environmental protection also argue for national standards, since individuals may have a right not to be exposed to more than a minimum level of risk.

The argument in favor of decentralization relies on the principle that the efficient level of protection is the level that balances costs and benefits (at the margin) for a given jurisdiction. Assuming that administrative economies of scale are not large, the argument in favor of decentralized standard setting will be

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17. For discussions of national versus local standard setting, see Wallace E. Oates, "The Environment and the Economy: Environmental Policy at the Crossroads," in John M. Quigley and Daniel L. Rubenfeld, eds., *American Domestic Priorities* (Berkeley: University of California Press, 1985); John H. Cumberland, "Interregional Pollution Spillovers and Consistency of Environmental Policy," in Siebert, *Regional Environmental Policy*; and Robert M. Schwab, "Environmental Federalism," *Resources*, Summer 1988, no. 92, pp 6-9.

18. This section of the paper assumes that national standards will tend to be uniform across jurisdictions.

stronger from an efficiency standpoint if three criteria are met: first, costs and benefits (and, thus, the efficient level of protection) must be shown to vary substantively among jurisdictions; second, political jurisdictions must capture essentially all externalities; and, third, decisions made by local jurisdictions must reflect these variations in costs and benefits.

Both the costs and the benefits associated with attaining a given level of environmental quality may vary significantly among jurisdictions for some pollutants, depending on the amounts and type of pollutants, the damages done by the pollutants, the concentration and age of industry, and geographic and climatic characteristics. For example, one study estimates that the level of total suspended particulates, a criteria air pollutant under the CAA, that balances costs and benefits in Baltimore is half that of the comparable level in St. Louis.19/ Allowing variation in local standards permits state and local governments to reflect these variations in local levels of environmental quality.

The efficiency and equity advantages of decentralized standards also depend on the extent to which the pollution problem follows political boundaries. If standard setting is decentralized to a level at which political jurisdictions with decisionmaking authority do not encompass most of the people receiving the benefits and costs of pollution control, then the wrong level of environmental quality may result. Some pollution problems are fairly local in impact, such as the containment of a hazardous waste site with confined contamination problems; however, many problems are multistate or regional in scope. In the latter category are the CAA's criteria air pollutants, along with water quality control problems for the Chesapeake Bay area and interstate water systems. The impacts of some pollution problems, such as acid rain and global warming, cross international boundaries.

Finally, the case in support of decentralized standards depends on the extent to which local or state jurisdictions will have good information about the costs and benefits associated with pollution control, and will set standards that reflect these costs and benefits. For several reasons, decentralized standards may result in too little or too much pollution control. First, state or local governments may engage in harmful interjurisdictional competition--reducing environmental standards in order to attract industry and jobs or in anticipation of reductions in standards in competing jurisdictions. Second, national government may be more sensitive to the benefits and costs received and borne by future generations or by lower-income individuals. Third, access to information is not costless; national governments may have more complete information, as well as the technical expertise needed to assess and understand the trade-offs involved. Unfortunately, while these arguments have intuitive appeal, there is not enough evidence to assess their validity and their implications for national versus local standard setting.

When the regulated industries engage in large amounts of interstate commerce, national standards and regulations may be preferred to decentralized control for both efficiency and equity reasons. Uniform programs reduce duplicative efforts and ease compliance for industry, and thus permit social goals

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19. Schwab, "Environmental Federalism."

to be achieved at lower cost. To the extent that it is more equitable for firms in similar situations (for example, having similar abatement costs) to face similar requirements, national standards provide this uniformity of treatment. For example, the Toxic Substances Control Act and the Federal Insecticide, Fungicide and Rodenticide Act regulate chemical production, distribution, and use for categories of chemicals and manufacturers; both these acts, which have implications for large industries operating across state boundaries, are administered at the federal level.

As discussed above, the case for regional or national standards is strengthened when pollution problems extend beyond state or local political boundaries. When substantial pollution externalities do not exist, however, an argument may be made for national standards based on the notion that every person has a right to a minimum standard of protection.20/ Uniform ambient standards limit potential exposure to health risks both for those living in an area and those passing through. A case for national standards can also be made based on interpersonal externalities, or altruism: a reduction in the pollution to which a person is exposed creates not only benefits for that person, but benefits on a national level, because other members of society value the benefits received by that person.

## Designing and Implementing Programs

In general, decentralization tends to promote efficiency in program design and development, to the extent that smaller units of government may be able to respond more rapidly and flexibly both to local circumstances and to changing problems and changing public preferences. They may also be more able to develop experimental and innovative policies and tools that result in lower-cost management of environmental problems.

For example, indoor air pollution is a problem nationwide, but is not a national problem in the sense of crossing local or state boundaries. Under constitutional and common law, state and local governments generally have purview over the types of statutes useful in combating this problem--for example, new building codes and land use restrictions. Thus, they may be better able than the national government to find practical and flexible solutions to particular local problems and pollutants.

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20. It should be noted that environmental protection in general, and uniform standards in particular, may promote the interests of the rich rather than the poor. To the extent that they do, they may not conform to notions of equity. For example, many of the benefits of water pollution control arise in the form of recreational rather than health benefits; recreational areas tend to be used more by the rich than the poor. Similarly, environmental protection leads to some plant closures or other transition costs; lower-income groups have less occupational and geographical mobility and thus may bear more of the burden. For a discussion of the distribution of benefits and costs in environmental protection, see Baumol and Oates, *The Theory of Environmental Policy*.

On the other hand, designing and managing environmental programs requires not only information on polluters and local pollution problems that is specific to the jurisdiction, but also general expertise on methods of managing environmental programs. Such knowledge includes general familiarity with available tools and their efficacy, as well as understanding of the technical relationships, such as the effectiveness of technological controls and the relationship between emissions and ambient concentrations, or between ambient levels and health effects and other damages. The greater the uncertainties as to the magnitude of health or output effects of pollutants, or their impact on the ecology, or the persistence of their effects into the future, the more difficult it will be for all jurisdictions to make informed decisions and design effective environmental management plans without federal assistance.

## Enforcement

Enforcement actions are designed to insure that overall program goals and standards are met. Enforcement occurs in two stages.21/ The first stage is monitoring and inspection, which may include determining whether the appropriate technology has been installed and is functioning, whether the quantity or concentration of emissions or discharges is within specified limits, and whether ambient concentrations are acceptable. If monitoring indicates that a violation may have occurred, then the second stage of enforcement can include requiring additional tests, meeting with the responsible parties, issuing notices of violations, and, finally, pursuing administrative, civil, or criminal penalties and proceedings.

The appropriate level of government to undertake these activities is that best able to develop and pursue effective policies. In turn, this depends on the tools that can be employed, the available knowledge concerning polluters and their potential responses to enforcement activities, the resources devoted to monitoring and subsequent proceedings, and the incentives for each level of government to carry out vigorous enforcement.

Under most statutes, enforcement authority has been delegated to the states along with program administration responsibilities. At the same time, the federal government remains responsible for overseeing state enforcement actions and retains authority to pursue direct enforcement activity against polluters. This allocation is not inconsistent with the efficiency and equity framework developed above. In general, the level of government with primary responsibility for daily program implementation is likely to have the best information on who the polluters are, what their responsibilities are under the program, and what sanctions they will be most responsive to. This level of government is thus ideally placed to undertake many enforcement activities. To the extent that smaller units of government have fewer legal constraints and levels of bureaucracy, they may be able to act more quickly or respond more flexibly to enforcement situations.

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21. Enforcement activities are described in Clifford S. Russell, and others, *Enforcing Pollution Control Laws* (Washington, D.C.: Resources for the Future, 1986) and Environmental Law Institute, *Law of Environmental Protection*.

Depending on the environmental problem, not all program responsibilities need be allocated to the same level of government. For example, responsibility for setting standards may be allocated to the national government, but most implementation responsibility may be given to the states, although that enforcement actions may be necessary at all levels of government. There may be several reasons for higher levels of government--in particular, national government--to become involved in enforcement. First, to the extent that national goals are more stringent that state goals, states may have an incentive to enforce less vigorously. Federal enforcement can be directed both at polluters in states and at the states themselves, as has occured in the case of deficient State Implementation Plans under the Clean Air program. Second, states may be subject to pressures to attract and retain industry, and thus may treat violations more leniently than strict enforcement of standards would suggest. Finally, the national government may have more resources, more technical expertise, and more statutory clout in dealing with polluters.

## Research and Development

Virtually every current federal environmental program assigns primary R&D responsibility to the federal government. Explicitly or otherwise, this recognizes that many environmental programs at different levels of government rely on similar types of information and that this information can often be provided more cost-effectively at a centralized level. Individual risk assessments on chemicals for use in setting drinking water standards, industrial-level technological control options under the Clean Water Act, and new technologies for hazardous waste disposal are all examples of federal R&D efforts the results of which may be used by federal, state, and local governments.

Some states, particularly those with high pollution levels and a high population concentration, have taken the initiative to construct data sets or technical information in support of new program development. For example, New Jersey and California have been at the forefront of state activity, and their programs have provided the models for subsequent federal legislation--such as the Community Right-to-Know provisions of the Superfund Amendments and Reauthorization Act, in the case of New Jersey. Thus, states do conduct R&D on their own, but the extent of these efforts is not clear. Most of the state-level efforts are probably related to the design, implementation, and monitoring of their own programs, rather than to basic science or technology that may have broader applications. For example, states have sometimes complained that they could do more to control their own sources of chemicals that lead to the formation of ozone (mostly volatile organic chemicals) if the federal government would complete more technical assessments of control options (called Control Technology Guidance documents) for specific sources. These documents do not apply to states or regions specifically but to classes of technologies.

As states take the lead in certain environmental problems, they may be forced to undertake more basic R&D programs to support their initiatives. For example, over one-third of all states have regulatory programs to control emissions of toxic chemicals into the air. Underlying these programs are at least four different principles for setting standards, each requiring different types of scientific and technical information. While some of the required information may be provided by the federal government, it is likely that states, or compacts of states, will have to look to their own research to meet their individual needs.

## Funding

In practice, the level of government responsible for decision making or program management is often responsible for funding that activity. This correspondence of program and funding responsibility is both intuitively appealing on equity grounds and consistent with the efficiency and equity guidelines described earlier. The level of government with program responsibility may be in the best position to determine funding needs and choose among alternative funding schemes. Aligning funding with program responsibility has the additional advantage of introducing accountability; responsibility for providing or collected funds generates an incentive for conservation and careful management of resources.

On the other hand, funding is unique among program activities because the allocation of responsibility for funding directly influences the distribution of the costs of a program.22/ Thus, there may be circumstances in which allocating funding responsibility on the basis of program responsibility may not always be equitable because the burden imposed on a particular group appears large in comparison to the ability of the group to meet the burden, or in comparison with the burden imposed on other groups in similar circumstances.

There are three situations in which additional outside funding, usually federal, may be justified: if costs of improvement or revenue-raising capacities vary among or within states; if uniform national requirements impose burdens on lower levels of government; or if burdens are distributed unevenly over time.

Adjusting for Local Differences. Abilities to raise revenues (fiscal capacities), and the costs of environmental improvement, vary among jurisdictions. Local circumstances, such as types and amounts of pollutants, meteorological conditions, and the age of the capital stock, differ among jurisdictions, so that the cost to industry and the local government of achieving a given level of quality (or a given reduction in pollution), or of providing a service such as wastewater treatment, varies. Similarly, differences in local economies, for example in the size of the tax base, mean that costs to consumers of obtaining a given service may vary among jurisdictions.

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22. Funding mechanisms, such as fees and charges, may also be used as regulatory devices. If the funding mechanism chosen depends on the level of government, its effect on efficiency and equity may depend on whether costs are met, for example, through general tax revenues or by charges on polluters, or through a combination of mechanisms. This paper is concerned only with the question of who should bear the administrative costs of running the program--not the question of which regulatory device should be used.

These differences form the basis for the argument made earlier that local governments are best able to adjust standards and programs to reflect local circumstances and to pursue efficient and equitable solutions for local problems. But there is another side to the picture: cost differences among localities may be viewed as inequitable, because people located in different jurisdictions will be required to pay different prices for a given level of environmental quality or a given improvement in the level of environmental quality. The inequities may extend to industry if similar industries located in different jurisdictions face different costs, either because they must meet different standards or because they must achieve different reductions in emissions to meet the same standard. If local cost differences represent inequities, then an argument can be made for using federal funds to equalize the "environmental purchasing power" of governments and industry through grants and subsidies.

While efficiency concerns may dictate that governmental units weigh local costs and benefits in choosing local levels or protection, equity considerations may suggest that access to some minimum level of protection should be available to all jurisdictions, regardless of ability to pay. This consideration is reflected in the principle of "equal treatment of equals", which underlies many conditional and matching grant programs such as vocational education grants.23/ Formulas for allocating grant money among jurisdictions reflect both the potential ability of a governmental unit to raise revenues internally and the cost of providing specified programs or services. Measurement of fiscal capacity has concentrated on designing indicators of relative ability among jurisdictions. Per capita income frequently is a key component of these indicators, which also may include adjustments for indirect business taxes, profits of state-local enterprises, and other indicators of resources that affect the ability of a governmental unit to raise revenue.24/

Lightening Heavy Burdens. Environmental protection may represent not only a relative but also an absolute burden on municipalities and industry, particularly if national standards or other national policies require lower levels of government to perform activities such as issuing permits or inspecting facilities. The amount of supplemental federal funding appropriate for these programs depends on several considerations.

The first consideration is the magnitude of the burden imposed on localities. The previous chapter of this paper presented evidence that state environmental budgets have been growing, which suggests that states in the aggregate have been able to replace declining federal aid with state or local funds. Whether or not states and municipalities can afford to pay for environmental programs is an empirical issue beyond the scope of this discussion; but the amount local

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23. Oates, *Fiscal Federalism*, p. 87.

24. For discussions of measures of fiscal capacity, see Department of the Treasury, Office of State and Local Finance, *Federal-State-Local Fiscal Relations: Report to the President and the Congress* (September 1985), and Advisory Commission on Intergovernmental Relations, *Measuring State Fiscal Capacity: Alternative Methods and Their Uses* (Washington, D.C., September 1986).

governments can raise to finance such projects may be limited by their taxing ability. As state and local governments develop the authority to charge fees and make use of other innovative means of raising revenue, replacement of federal grants may become more feasible.

Whether or not federal grants are warranted depends also on the justification for national control of state and local environmental activities. Many activities required of state or local governments by higher levels of government can be justified on the basis of externalities--that is, when the benefits of environmental improvement extend beyond a given jurisdiction, as is the case in most water or air pollution issues. Funding provides a mechanism for the federal government to persuade, control, or bargain with state and local governments when national policies differ from those that a state or locality would choose.

Compensating the Losers. Federal funding may also be justified when the burden of complying with federal regulations is unevenly distributed over time or regions. Many pollution problems are the result of long-entrenched geographic concentrations of industry. In the case of acid rain, a substantial portion of the benefits of sulfur dioxide controls are received by the Northeast region, while much of the costs are borne by coal-producing states, in terms of lost jobs and higher energy costs. Requiring industry and state and local governments in the Midwest to bear the burden of emission controls or energy taxes may be equitable in the long run under the damages principle, but may be unfair in the short run because of high transition costs. One way of avoiding serious dislocation costs would be to have the federal government, or the states receiving benefits, compensate the losers in the Midwest. Otherwise, states in the Northeast will receive windfall benefits at the same time that Midwest states are penalized for location and polluting decisions that were made long before the pollution control laws came into existence. A similar effort has already been made to ease the cost of transition under the wastewater treatment program by providing federal construction grants.

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# Municipalities, Small Business, and Agriculture

## The Challenge of Meeting Environmental Responsibilities

# MUNICIPALITIES, SMALL BUSINESS, AND AGRICULTURE: THE CHALLENGE OF MEETING ENVIRONMENTAL RESPONSIBILITIES

REPORT TO LEE M. THOMAS

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## CONTENTS

Page

EXECUTIVE SUMMARY . . . . . . . . . . . . . . . . . . . . . . i

Chapter 1 INTRODUCTION . . . . . . . . . . . . . . . . . . . . . . . 1-1

The Changing Nature of Environmental Regulations . . . . . . . . 1-1
The Need for Broader Analyses . . . . . . . . . . . . . . . . . . 1-3
The Sector Studies . . . . . . . . . . . . . . . . . . . . . . . . 1-3

Chapter 2 MUNICIPALITIES . . . . . . . . . . . . . . . . . . . . . . 2-1

Municipalities and Environmental Regulations . . . . . . . . . . 2-2
Study Methodology and Limitations . . . . . . . . . . . . . . . 2-6
The Impact of Environmental Regulations . . . . . . . . . . . . 2-11
Conclusion . . . . . . . . . . . . . . . . . . . . . . . . . . . 2-19

Chapter 3 SMALL BUSINESS . . . . . . . . . . . . . . . . . . . . . . 3-1

Small Business and Environmental Regulations . . . . . . . . . . 3-1
Study Methodology and Limitations . . . . . . . . . . . . . . . 3-4
Impacts Upon Selected Industries . . . . . . . . . . . . . . . . 3-6
Conclusion . . . . . . . . . . . . . . . . . . . . . . . . . . . 3-16

Chapter 4 AGRICULTURE . . . . . . . . . . . . . . . . . . . . . . . . 4-1

Agriculture and Environmental Regulations . . . . . . . . . . . 4-2
Study Methodology and Limitations . . . . . . . . . . . . . . . 4-3
Impacts on Livestock and Major Field Crops . . . . . . . . . . . 4-8
Impacts on Specialty Crops . . . . . . . . . . . . . . . . . . . 4-12
Conclusion . . . . . . . . . . . . . . . . . . . . . . . . . . . 4-15

Chapter 5 POLICY CONSIDERATIONS . . . . . . . . . . . . . . . . . . . 5-1

Municipalities . . . . . . . . . . . . . . . . . . . . . . . . . 5-1
Small Business . . . . . . . . . . . . . . . . . . . . . . . . . 5-5
Agriculture . . . . . . . . . . . . . . . . . . . . . . . . . . . 5-8

Appendix Environmental Regulations Included in the Sector Studies

## EXECUTIVE SUMMARY

Over the years, the U.S. Environmental Protection Agency's (EPA) mission has broadened considerably, and so has its reach into society. New regulations of toxic materials, hazardous substances, and solid wastes will affect hundreds of thousands of farms and small businesses, and new drinking water regulations will affect tens of thousands of small municipalities. This report summarizes the findings of three studies designed to take a first look at the combined impacts of EPA's new regulations upon municipalities, small business, and agriculture.

The sector studies examined 85 recent and forthcoming environmental regulations that have the potential for large and far reaching impacts. The costs of existing environmental regulations and all other government programs were assumed to remain constant over the study period. Although the regulations included in these studies will lead to improvements in environmental quality, the sector studies do not assess the benefits that will accrue to the municipal, small business, and agricultural sectors.

Because the sector studies were meant to be initial efforts, they are subject to a number of qualifications. For example: (1) each study limits the range of its analysis by selecting a sample of sources, and (2) the costs and even the final forms of many of the regulations studied are not yet certain. In spite of these limitations, the sector studies provide an initial reading of the potential impacts of the new environmental programs and suggest several potential policy initiatives that may prove useful.

### MUNICIPALITIES

Recent revisions to environmental legislation have established a broader and more stringent set of standards to be met by municipalities. Meeting these new standards will require additional investments in capital, and increases in rates charged to customers for improved environmental services.

The potential cumulative cost of the environmental regulations examined in the municipal sector study may require that the national average household spend an additional $100 per year by 1996. Both municipalities under 2,500 persons and over 250,000 persons will experience the largest average increases in total user charges and fees paid on a per household basis, with potential average annual increases in user charges and fees of $170 and $160, respectively. Because smaller municipalities tend to have lower average household incomes and higher unit costs for improved environmental services, however, households in communities under 2,500 persons will be required to pay a greater proportion (0.7%) of their income, on average, for these services than will households in larger cities (0.5%).

Most municipalities will be able to meet the expected increases in environmental expenses and still remain financially sound. The municipalities most likely to experience difficulty will be those with populations of 2,500 or less. Between 21% and 30% of these communities may have difficulty because of the high cost of some individual regulations, the cumulative costs of recent legislative requirements, and the limited margin for expanding financial obligations in small communities due to existing demands for environmental and other infrastructure services. These difficulties are not limited to small cities, but the results suggest that a much smaller proportion (between 3% and 7%) of the cities over 2,500 persons will face financial constraints when subject to additional EPA requirements.

The individual environmental regulations that account for the largest potential increases in expenses in small communities are the drinking water and sewage treatment requirements. Several of the more costly drinking water regulations will apply to a greater proportion of smaller municipalities than larger municipalities. These regulations do not single out smaller municipalities per se, but instead deal with environmental risks that are present at smaller community water systems. Many larger water supply systems already have introduced treatment systems capable of handling some of these risks. The costs of solid waste disposal, asbestos removal in schools, and underground storage tank regulations, when totalled, also account for a significant portion of the costs borne by smaller communities.

## SMALL BUSINESS

Although it might seem that EPA's 85 regulations would overwhelm any small business, the actual impacts will vary greatly. Most small businesses will not be affected directly by any of the 85 regulations. Some firms will be affected adversely by the regulations, but others -- particularly those that provide pollution control products or services -- will find that their businesses grow. Thus, the overall impact of EPA's forthcoming regulations is by no means self-evident.

An examination of statistics provided by the U.S. Small Business Administration (SBA) reveals that seventy percent of the 3.5 million small businesses in the United States are in sectors of the economy that produce little or no pollution -- wholesale and retail trade, finance, and services. Most of these businesses will not be affected directly by any of the 85 regulations. Small businesses that contribute to environmental problems will incur additional costs to comply with the regulations, however, and in some industries the costs may be high.

The small business sector study examined the impacts on small businesses in nine industries judged likely to be adversely affected by several environmental regulations. The study found that costs may be high for small businesses in three of the industries -- electroplating, wood preserving, and pesticide formulating and packaging. If costs prove to be as high as estimated and cannot be passed on to consumers, some small businesses in these industries may be forced to discontinue part of their operations or to close. Some small dry cleaners that have underground storage tanks or require substantial perchloroethylene emissions controls may also have difficulty meeting environmental requirements. In addition, certain gas stations, trucking firms, and farm supply stores with leaking underground storage tanks may face corrective action costs beyond their financial means. Small private water supply companies are in a unique position, in that they operate as utilities and generally obtain rate increases to cover increased costs. While these firms would not be expected to go out of business, high environmental costs for water supply companies that fail to meet new drinking water standards may necessitate large increases in household usage fees. Environmental costs for one of the industries studied--photofinishing laboratories -- were found to be negligible.

The regulations that appear to be most often responsible for high costs in the industries studied are those covering the handling and reporting of toxic chemicals; the handling, treatment, and disposal of hazardous wastes; and the operation of underground storage tanks. Although cost estimates are available for only some of these regulations, those that are available indicate that the regulations will affect a large number of firms in many industries and may entail costs in the $5,000 to $10,000 range. Although these costs may be managed easily by small businesses of moderate size, they present difficulties for businesses with fewer than twenty employees. It is these very small businesses that comprise the majority of U.S. businesses.

## AGRICULTURE

The objective of the agriculture sector study was to examine the cumulative effect of recent and proposed future EPA actions on the financial condition of farms in the United States. Because of the complexity of the agricultural sector and the many uncertainties that still accompany the new environmental programs, this study had to limit its focus to a few "representative" farm types and had to make many assumptions about future environmental requirements and other factors that will affect the financial condition of farms, such as farm support programs under the Food Security Act.

For livestock and major field crops, three specific farm types were examined: (1) an Illinois corn soybean farm, (2) a Mississippi cotton soybean farm, and (3) a Kansas cattle wheat farm. For specialty crops, six crops were selected: apples, tomatoes, potatoes, peas, caneberries (e.g., raspberries, blackberries, etc.), and peanuts. There proved to be insufficient information to complete the analysis for caneberries and peanuts, however, so that results are available only for apples, tomatoes, peas, and potatoes. The difficulty in obtaining information about producers of specialty crops was itself a significant finding of the study.

Three regulatory scenarios of future EPA actions were considered in the agriculture sector study, ranging from a conservative (low cost) scenario to an expansive (high cost) scenario. In addition, two alternative levels of effects were considered for each of the farms that were examined. In an average impact case it was assumed that the farm would incur the average environmental costs of all farms of that type and in a maximum impact case it was assumed that the farm would incur all of the environmental costs that a farm of that type might face. The maximum impact cases represent very unlikely worst cases, but provide an upper bound on the potential losses under each regulatory scenario.

For the three types of major field crop and livestock farms examined in this study, the effects of EPA actions on farms in different financial conditions were considered. The loss in income incurred by farms in average financial condition under the average impact case (average environmental costs) was 3% or less under each of the regulatory scenarios considered. Losses of this magnitude resulted in only very small changes in these farms' debt to asset ratios (less than 1%). Under the unlikely maximum impact cases, farms in average financial condition experienced substantial losses in income, but were not forced out of business as a result of EPA actions.

The major field crop and livestock farms in vulnerable condition were more sensitive to increased environmental costs than their counterparts in average financial condition. Although the absolute reduction in income was similar for farms in vulnerable and average financial condition under each scenario, these losses resulted in much larger changes in the vulnerable farms' debt to asset ratios. Even though the vulnerable farms' financial conditions were found to deteriorate more than the farms in average financial condition, only one of the vulnerable farms was predicted to go out of business during the forecast period (1987-1996). The Kansas wheat cattle farm in vulnerable financial condition was predicted to go out of business even without any environmental costs and was predicted to go out of business one year earlier than it otherwise would have under one of the regulatory scenarios considered.

Because of limited data availability, the study did not forecast losses in income or changes in debt to asset ratios for specialty crop farms. Instead, it examined changes in net returns per acre (which reflect returns to land and farmer provided labor). Under the least costly regulatory scenario, the changes were generally less than 1% for farms experiencing average environmental costs and less than 8% for even the maximally affected farm. Under the most costly regulatory scenario, however, losses of the average impacted producers increased substantially, particularly for apple producers in New York and Michigan, where predicted losses were 60% and 84%, respectively. These dramatic decreases in net returns may bring about substantial structural changes in the production and markets for the crops affected. Large differences in the impact of EPA regulations on crops grown in different regions occurred because some of the proposed restrictions involve pesticides that are used in some regions and not in others. Even though the results of this study must be considered preliminary, these figures show that EPA actions could create economic problems for some specialty crop farms and suggest that the Agency exercise caution in this area.

## POLICY CONSIDERATIONS

In response to the findings of these sector studies, several areas for potential policy initiatives have been suggested. While none has been endorsed by the Sector Study Steering Committee, they are presented to illustrate the kinds of activities that might be considered and to promote further discussion.

### Municipalities

A number of activities have been implemented by EPA and other initiatives have been suggested to support small communities' compliance with environmental regulations. These include establishing better lines of communication among EPA, community leaders, and citizens, and extending technical and financial assistance programs, as well as several more innovative programs. Public partnerships might be promoted, for example, to allow two or more communities to share expertise, purchase services and goods in larger volumes for discounts, or to raise capital in larger, more cost-effective blocks. Regionalization is a more structured form of partnership, in which two or more communities create a joint venture for a particular purpose, such as construction of a water supply system. Privatization, in which communities work with private companies to assist in the provision of environmental services, is another concept that might be promoted to help reduce costs.

An important finding of the municipal sector study is that not all communities are expected to face financial difficulties. This fact suggests that further analysis should be conducted in order to identify the characteristics of small and large communities that make them more likely to experience difficulty in financing and affording new environmental protection. If EPA can better identify those characteristics, then it can improve upon its current efforts to design and implement programs that will be of greatest benefit to those communities most in need of assistance.

### Small Business

Because the new environmental programs cut across many industries and affect thousands of small businesses, new compliance strategies may be needed to supplement EPA's traditional enforcement efforts. Many policy initiatives are available to help small businesses learn about and comply with the new environmental regulations. These include educational programs, preparing standardized responses to paperwork and other requirements, helping to expand environmental services, and fostering new technologies. All of these potential programs can be developed with the cooperation of other government agencies and with industry trade associations.

This study has highlighted the value of detailed small business analyses and the importance of maintaining a current small business data base. The Fin/Stat data base used in this study was compiled by the SBA, but was discontinued in 1983. Although slightly out of date, the data enabled the analysis to focus on the smallest of businesses. EPA might consider working with SBA and other interested agencies to fund a common small business data base that could be used for all economic analyses, particularly the small business analyses required under the Regulatory Flexibility Act.

### Agriculture

The agriculture sector study illustrates the advantages of examining the impacts of environmental regulations at the farm level as well as at the aggregate national level. While national analyses provide useful information concerning the total losses incurred by different aggregate types of farmers (e.g., corn farmers as a whole), the impact of environmental regulations on farms' financial conditions depends on the distribution of those losses among farmers and on the initial financial conditions of the affected farms. In order to determine the effect of EPA regulations on the ability of farms to survive, both aggregate and farm level analyses are necessary.

This study highlights the data and analytical requirements necessary to determine the impacts of EPA actions on agriculture. Such requirements include accurate pesticide usage and efficacy data, improved national commodity price-quantity models, and better information on the financial and production conditions of farmers. The importance of using farm level models and improving data and modeling capabilities is likely to increase in the future as EPA tries to cost-effectively reduce environmental risks associated with agriculture.

## Chapter 1

## INTRODUCTION

Environmental regulations touch all sectors of society -- agriculture, business, government, and individuals. As these regulations have evolved, their impacts upon society have evolved as well.

When the U.S. Environmental Protection Agency (EPA) was founded in 1970, environmental regulation focused on the major sources of air and water pollution--principally the "smokestack" industries and large municipalities. Over the years, EPA's mission has broadened considerably, and so has its reach into society. New regulations of toxic materials, hazardous substances, and solid wastes will affect hundreds of thousands of municipalities, small businesses and farms, and new drinking water regulations will affect tens of thousands of municipalities and water supply systems.

This report summarizes the findings of three studies designed to take a first look at the combined impacts of EPA's new regulations upon municipalities, small businesses, and agriculture. Because the scope of environmental regulation is broadening to affect these sectors of society more and more, the Agency has commissioned these studies to provide an initial assessment of what economic problems, if any, can be expected to arise and to suggest areas for more detailed study.

### THE CHANGING NATURE OF ENVIRONMENTAL REGULATIONS

In 1970, the most pressing environmental problems seemed obvious, and the perpetrators easy to identify. Soot and smoke from automobiles and smokestacks were fouling our air, and sewage and wastewaters from municipal and industrial outfalls were contaminating our rivers and streams. Air and water pollution regulations have done a great deal to abate these more visible forms of pollution. The air in most of our cities today is far cleaner and healthier. Thousands of miles of rivers and streams, and thousands of acres of lakes, have been restored for fishing and swimming. These accomplishments are especially impressive when seen in the context of the economic expansion and population growth that occurred during the same period. There are 25 percent more people in the United States now than 20 years ago, and our gross national product has increased by over 60 percent.

But the job is far from finished. As EPA is continuing to implement traditional environmental programs, it also is confronting new challenges. Environmental dangers from the use of toxic substances and the disposal of hazardous wastes are now a major concern. More and more contaminants are being discovered in our drinking water, so that the Agency is taking a new look at drinking water standards and is putting in place programs to protect our groundwater from pesticides and leaking underground storage tanks.

These new environmental programs present regulatory problems that in many ways are similar to traditional pollution control programs. As with existing air and water regulations, the Agency must determine how stringent standards should be and what technologies are available to meet those standards. The new programs also present some new challenges, however. One of these is assuring the compliance of the ever-increasing number of smaller and smaller sources that are covered by the new regulations. Over the past twenty years, the Agency has developed complex permit programs that govern the discharge of contaminants by large facilities. Now, EPA must establish programs that govern the activities of hundreds of thousands of small sources.

Congress recognized the fact that small sources were an important future challenge when it amended the Resource Conservation and Recovery Act (RCRA) in 1984 to include generators of relatively small volumes of hazardous waste. These amendments extended RCRA's coverage from about 15,000 facilities to over 200,000 facilities.

The underground storage tank (UST) program covers even more facilities. Literally millions of USTs are located throughout our country in every imaginable setting. Gasoline service stations operate about half of these USTs, but the remainder are operated by a diverse community, including trucking companies, dry cleaners, farm supply stores, chemical companies, local and state governments, military installations, and airports. Altogether, over 500,000 facilities are covered by the UST regulations.

The new environmental programs not only bring many new sources into the regulated community, but also bring many new regulations to bear on sources that before were regulated less intensively. Farmers, for example, once were not regulated directly, but were affected by restrictions on which pesticides they could use. Now, farmers not only are encountering more pesticide restrictions, but also must comply with new regulations covering surface water runoff, the storage and handling of pesticides and other toxic substances, and the disposal of hazardous wastes. There are over 2,000,000 farms in the United States today.

Municipalities provide an even more striking example of the broad scope of the new environmental programs. There are over 35,000 municipal governments in the United States that are covered by EPA's regulations and many more separate government jurisdictions, including water supply districts and school systems. Although local governments provide a broad range of services, the only significant environmental regulations that affected them in 1970 were those pertaining to sewers and wastewater treatment. Now, municipalities find that several of their services are governed by environmental regulations. Two services commonly provided by local governments -- waste disposal and drinking water supply -- are the primary focus of new environmental programs. In both of these areas, programs encompassing several new environmental regulations are bringing about significant changes. In addition, municipalities are required to form local planning committees to coordinate plans for dealing with hazardous substance emergencies. Even local school systems, hardly considered polluters in the conventional sense, now find that they must comply with new regulatory programs covering asbestos and radon contamination.

In today's complex environmental setting, EPA's regulatory mission is governed by major laws covering air and water pollution; radiation; the protection of drinking water; the treatment, storage, and disposal of hazardous wastes; the use of toxic chemicals and pesticides; and the storage of substances in underground tanks. Not only do EPA's environmental regulations touch every sector of American life, but each sector finds itself covered by several different kinds of environmental regulations.

## THE NEED FOR BROADER ANALYSES

EPA has been analyzing the impacts of its regulations since its inception, both to provide information essential to fulfilling its statutory responsibilities and also to comply with executive orders. Each of the major environmental statutes designates different factors that EPA must consider when establishing environmental regulations. At the same time, EPA must provide regulatory analyses for review by the Office of Management and Budget (OMB). Beginning with the "Quality of Life" reviews under the Nixon Administration, the requirements for review by OMB have evolved from a relatively simple analysis of costs to the comprehensive benefit-cost analyses required for today's Regulatory Impact Analyses (RIAs).

As the analytic techniques and data sources available to EPA have improved, the regulatory analyses performed as part of the rulemaking process have become increasingly sophisticated. Their focus, however, has remained on individual environmental regulations. When one sector of society or one industry is affected by several environmental regulations, each analysis of an individual regulation paints only part of the total picture. Recognizing this, EPA from time to time has examined the combined impacts of several existing regulations on a few major industries. Furthermore, EPA's periodic Cost of Clean Air and Cost of Clean Water reports examine the overall impacts of existing environmental regulations on the entire U.S. economy. EPA has never taken a broad look at the sectors included in this report, however, nor has it taken a prospective look at the entire range of forthcoming environmental programs.

The changing nature of environmental programs has prompted many questions about their potential impacts on the various sectors of society. Will farmers, small businesses, and local governments be able to afford the combined costs of the new environmental programs? Will they be able to carry out all of the required activities? Where are problems likely to arise? To answer these questions, broader analyses are needed -- analyses that look at entire sectors of the economy, span the complete spectrum of environmental programs, and include forthcoming regulations as well as those already on the books.

## THE SECTOR STUDIES

The three sector studies summarized in this report represent EPA's initial efforts to examine the overall impacts of new environmental programs on agriculture, small businesses, and municipalities. They are not meant to be exhaustive studies, and their conclusions must be regarded as tentative. Rather, they must be regarded as pilot studies intended to shed a first light on areas where potential impacts can be expected and to provide guidance for further study.

The sector studies examine 85 recent and forthcoming environmental regulations. Although EPA may issue over 200 regulations in a single year, most of these regulations are relatively minor, without broad-ranging effects. Only 5-10 of the regulations issued in a single year may be considered to be major. The 85 regulations examined are those deemed to have the potential for large and far reaching impacts. All other costs, including those of existing environmental regulations and other government programs, were assumed to remain constant over the study period.

Appendix A presents a list of the 85 environmental regulations covered in the three sector studies. Because the titles of most of these regulations are rather long, the sector studies refer to the regulations by the short titles listed in the appendix. These short titles were created for the sector studies and may differ from titles used in other EPA publications.

Because the sectors studied are fundamentally different, each study employs a different approach. The municipal study uses a newly developed model of municipal finances to determine the financial conditions of 270 randomly selected municipalities with and without the regulations. The small business study focuses on nine industries (1) that will be required to comply with a number of environmental regulations, and (2) that contain a high percentage or high number of small businesses. The agriculture study examines the impacts of environmental regulations on a selected set of livestock, major field crops, and specialty crop farms.

Because the sector studies were meant to be initial efforts, they are subject to a number of qualifications. For example:

1. Each study limits the range of its analysis by selecting a sample of sources. While the municipal study uses a random sampling process, the small business and agriculture studies focus on sources that will be most affected by the regulations. Thus, these two studies are not so much representative of the sectors studied, as they are illustrative of the heavily impacted segments of those sectors.

2. Because many of the regulations included have not yet been promulgated, the costs and even the final forms of the rules are not yet certain. Thus, the studies' conclusions about the impacts of some regulations may prove to be inaccurate, should those regulations not be promulgated in the forms assumed.

In spite of these limitations, the sector studies provide an initial reading of the potential impacts of the new environmental programs. The methodology, major limitations, and principal conclusions of each of the studies are summarized in the following three chapters. The final chapter presents a summary of the policy initiatives that have been suggested as a result of these three sector studies.

## Chapter 2

## MUNICIPALITIES

Municipalities play a major role in supplying environmental services. Local governments have taken responsibility for providing drinking water, sewage treatment, and waste disposal in a majority of communities. Over the past fifteen to twenty years, most of the mandates found in the federal environmental legislation enacted in the early 1970s have been met. The increase in the number of people served and improvements in the quality of local environmental services has been considerable, as has the investment in public infrastructure to meet these laws.

Recent revisions to the environmental legislation have established a broader and more stringent set of standards to be met by suppliers of environmental services. As a result, many local governments are now faced with having to maintain all or some part of their public services at a higher level of performance. To meet these new standards will require additional investments in capital, and increases in rates charged to customers for environmental services.

Improvements in environmental services is but one of several demands being made of local public infrastructure. Studies prepared on public infrastructure needs and the availability of funds to meet these needs indicate that there may be an excess demand for financial resources to rebuild and improve upon the existing stock of public infrastructure. Therefore, it is important to recognize that additional environmental requirements may have to compete with other infrastructure needs (e.g., highways, bridges), as well as other public services (e.g., police, education, health and welfare programs) provided at the local level.

Given the increasing demand for public services, this study* examines what additional investments the new environmental legislation will require local governments to undertake, and the likelihood that they will face difficulties raising the necessary funds through capital markets and revenues from customers. The economic impacts of individual future EPA actions are considered during the regulatory process in those situations permitted by environmental statutes. The unique feature of this study is its attempt to estimate the cumulative costs and impacts of meeting a combined set of EPA requirements, and to determine whether they may place a significant burden on the fiscal conditions of local governments, and require them to significantly increase existing charges for improved environmental services.

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* The Municipal Sector Study - Impacts of Environmental Regulations on Municipalities; prepared for the U.S. Environmental Protection Agency, Office of Policy, Planning and Evaluation by Jasbinder Singh, Raffael Stein, and Sanjay Chandra of Policy, Planning & Evaluation, Inc. and Brett Snyder of EPA; September 1988.

## MUNICIPALITIES AND ENVIRONMENTAL REGULATIONS

Because municipalities* are a primary provider of environmental services, they are also the focus of many regulatory programs. Drinking water standards, for example, establish criteria for the quality of the water that is supplied by municipalities to their residents. Water pollution control standards establish how municipal sewage is to be treated, and solid waste regulations govern how the sludge from wastewater treatment is to be disposed. Other solid waste regulations set standards for building and operating municipal waste disposal and treatment facilities.

In addition to these environmental services, a number of other municipal activities fall under the control of environmental regulations. Most municipalities store fuel for their vehicles in underground storage tanks that are subject to EPA regulations. Schools and other public buildings must meet EPA standards for asbestos. Municipalities must also meet the requirements of new environmental regulations that govern the reporting of and emergency planning for users of toxic chemicals.

The ability of a municipality to meet the requirements of environmental regulations depends not only on which regulations it must meet, but also on its financial health and on how it organizes its environmental services. Geographic, demographic, and political factors all contribute to a municipality's decision to own, operate, and choose the level of environmental services it will provide its residents. In addition, municipalities that allocate resources to environmental services may effectively reduce expenditures for health care, welfare, and housing. Communities that reduce environmental risks may succeed in reducing medical and disability costs from pollution-related illnesses, and limit the damaging effects of pollution to the existing infrastructure (e.g., roads, bridges, buildings). As shown in Figure 2-1, the relative proportion of a municipality's budget allocated to environmental services falls as the size of the community rises. The environmental costs in the figure include annual operating and capital costs for drinking water, wastewater treatment, and solid waste disposal. Other miscellaneous expenditures associated with asbestos removal or underground storage tank technical and financial standards are not included in this figure. Therefore, these percentages may underestimate the proportion of current municipal budgets expended on all environmental services.

The top graph in Figure 2-2 shows how the average percent of household income expended on drinking water, wastewater treatment, and solid waste disposal

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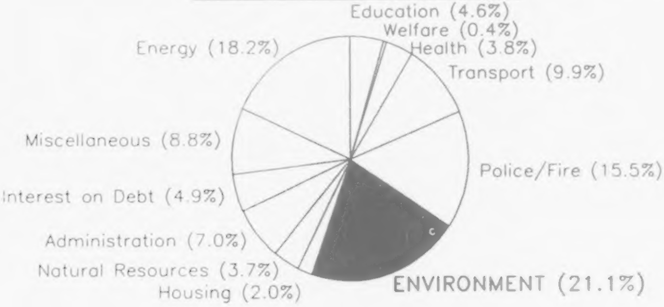
*For purposes of this study, municipalities are defined as those government bodies defined by the U.S. Bureau of the Census as municipal governments and township governments. Municipal governments are political subdivisions within which a municipal corporation has been established to provide general local government for a specific population concentration in a defined area. This includes most units designated as cities, boroughs, towns, and villages. Townships exist to serve inhabitants of areas defined without regard to population concentrations. This includes units designated as towns, plantations, locations and townships. For further discussion, see 1982 Census of Governments, Volume 1: Governmental Organization.

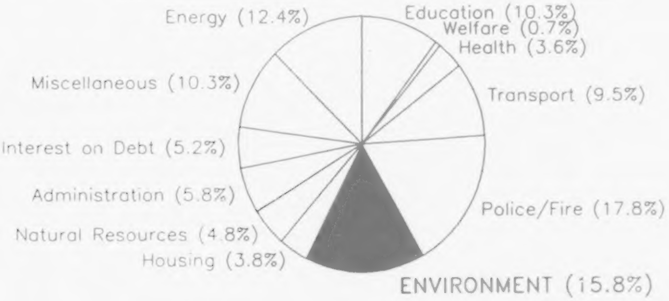
Figure 2-1

## DISTRIBUTION OF MUNICIPAL EXPENDITURES FOR SERVICES IN 1984–1985

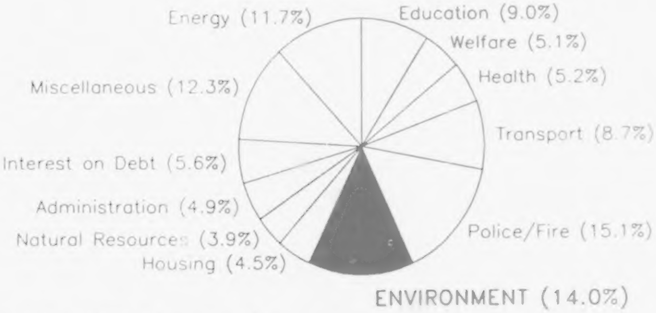
Municipalities Under 50,000 Persons



Municipalities Between 50,000 and 250,000 Persons



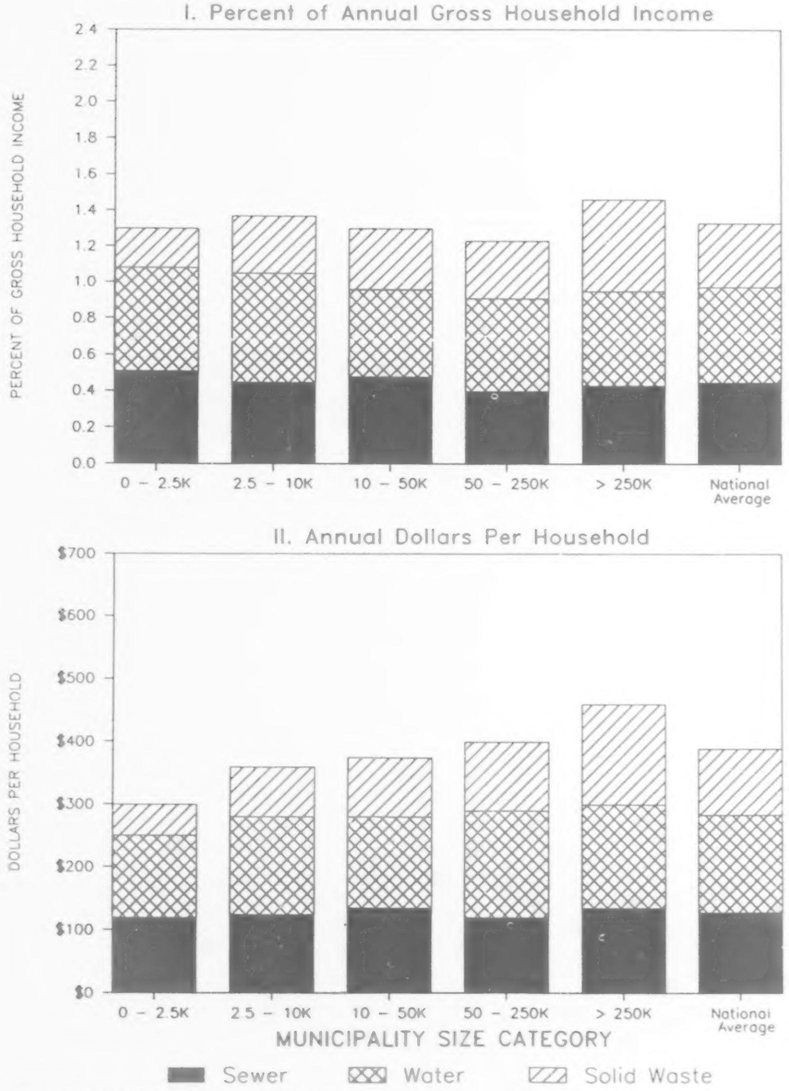
Municipalities Over 250,000 Persons



Source: 1984–1985 Census of Governments – City Finances

**Figure 2-2**

CURRENT AVERAGE ANNUAL HOUSEHOLD COSTS FOR ENVIRONMENTAL SERVICES



Source: Municipal Sector Study Database

services varies by size for municipalities sampled in the study. The lower portion of the figure shows the dollar expenditures for these same services. The differences between the two presentations is attributable to several factors. For example, the percent of household income spent for drinking water and wastewater treatment services tends to fall as municipality size increases, but dollars expended for these services remains constant or rises with population. Smaller communities tend to have lower average household incomes than do larger communities. Therefore, households in smaller municipalities must spend a larger proportion of their income than households in larger communities in order to expend equivalent dollar amounts.

For many environmental services, the ability of larger communities to take advantage of scale economies will allow them to enjoy lower unit costs for services than consumers living in smaller communities. The numbers in Figure 2-2 do not show a large decline in expenditures as population size rises. These lower unit costs are partially offset by greater consumption of these services, so the total user fees paid by households in larger municipalities can be comparable, on average, to fees paid by households in smaller communities. Grants and loans to communities have also helped to lower household costs for drinking water and wastewater treatment services, but it is not clear that the distribution of assistance has been weighted in favor of small versus large communities. An additional factor contributing to the similarity in costs across municipality sizes is the more advanced average level of services provided in larger municipalities. Larger communities have invested in more advanced and costly treatment technologies, which can offset the advantages of scale economies for comparable levels of services. The net result is that households in smaller communities generally spend a larger portion of their available resources-- when measured as a percent of household income -- to obtain drinking water and wastewater treatment services than do households in larger communities.

Likewise, although scale economies may also occur in solid waste treatment, the costs in Figure 2-2 do not reflect this. The higher relative household costs of solid waste disposal for larger municipalities are primarily due to the limited number of requirements currently affecting smaller communities, and the reliance of some larger communities on more sophisticated and costly disposal techniques.

When improved environmental services are supplied by municipalities, the additional costs of raising capital to begin construction of facilities can be funded through different revenue-raising mechanisms. Current revenues, or "pay-as-you-go" financing, uses a proportion of revenues to support a capital reserve account. The revenues may come from taxes or usage fees. This method has often failed to provide for adequate reserve funds capable of financing large capital investments. Smaller communities are more likely to use this mechanism, given the amount of capital they require is often small. They are also likely to use this mechanism because they lack sufficient expertise and fiscal capacity to raise funds through bond markets.

Debt service financing involves the issuance of bonds to finance construction of large-scale projects. General obligation (g.o.) bonds are repaid with revenues raised from property or income taxes. They are best applied in situations where the general public benefits from the project, such as with public education or transportation systems. Revenue bonds are supported by the user charges assessed to customers directly benefiting from the project. Since revenue bonds rely on customer payments and g.o. bonds rely on the taxing authority of the local government, the revenue bonds are perceived as more risky to investors and, therefore, require a higher rate of return on the amount invested. Revenue bonds can be a more accessible financing instrument than g.o. bonds, since local governments may be constrained by federal and state statutes as to the amount of debt the community can issue, or the amount it can increase tax rates. Revenue bonds are now the preferred choice of local municipalities to finance drinking water and wastewater treatment projects. There is also increasing interest in their potential use for solid waste treatment projects.

The declining availability of federal grants has contributed to the greater interest in alternative financing mechanisms. A substantial proportion of the capital investment in wastewater treatment since passage of environmental legislation in the early 1970s has been financed with federal and state grants. Grants were once a major source of capital financing for many public infrastructure programs. These programs have been reduced in favor of federal, state, and local government loan or debt financing programs. Although federal and state grants will continue into the next decade, funding levels will decline, so alternative financing mechanisms will be adopted to meet increasing demands for resources.

## STUDY METHODOLOGY AND LIMITATIONS

This study examines the impacts of recent and forthcoming environmental regulations upon user charges and finances in municipalities. The outputs of the study include projections of the cumulative costs to communities of upcoming actions, the proportion of communities expected to face potential difficulties meeting the household user charge increases necessary to pay for additional requirements, and the proportion of communities that may have financial difficulties meeting the requirements given their present financial conditions.

In addition to having to use a relatively small sample of communities, the study had to rely upon a number of simplifying assumptions, including the omission of several important environmental regulations for which estimated costs are not yet available and the use of economic indicators to assess household burdens and financial capabilities of municipalities to fund improvements in environmental services.

### Methodology

This study used EPA's MUNFIN model of municipal finances to calculate the effect of adding the estimated aggregate costs of environmental regulations to the current user charges and financial statistics of 270 sampled municipalities. As indicators of potential financial difficulties, the study examined several measures of the predicted increases in user fees and municipal debt. The environmental regulations considered in the sector study are listed in Table 2-1. The overall methodology is summarized below.

The study estimated the cost and the incidence rate of each environmental regulation for municipalities in each size category in order to produce "probabilities of occurrence" and the relevant associated capital, maintenance, and administrative costs. The probabilities and cost figures were used to determine the weighted average costs of each new requirement, and cumulative totals of weighted average

### Table 2-1

### LIST OF REGULATIONS CONSIDERED IN THE MUNICIPAL SECTOR STUDY

| Regulations Included in the Cost Analysis | Regulation Status |
|---|---|
| **A. Drinking Water** | |
| 1. Inorganic Compounds (IOCs) | In Development |
| 2. Synthetic Organic Compounds (SOCs) | In Development |
| 3. Volatile Organic Compounds (VOCs) | Promulgated |
| 4. Fluorides | Promulgated |
| 5. Lead and Copper Corrosion Control | Proposed |
| 6. Lead and Copper MCL | Proposed |
| 7. Coliform Monitoring | Proposed |
| 8. Surface Water Treatment Rule: Filtered | Proposed |
| 9. Surface Water Treatment Rule: Unfiltered | Proposed |
| 10. Radionuclides | In Development |
| 11. Disinfection | In Development |
| **B. Wastewater Treatment** | |
| 1. Secondary Treatment of Municipal Wastewater | Promulgated |
| 2. Pretreatment Requirements | Promulgated |
| 3. Sewage Sludge Disposal - Technical Regulations for Use and Disposal | In Development |
| **C. Solid Waste Disposal** | |
| 1. Municipal Landfill Subtitle D Criteria | Proposed |
| 2. Municipal Waste Combusters - Air Standards | In Development |
| 3. Municipal Waste Combusters - Ash Disposal | In Development |
| **D. Miscellaneous Regulations** | |
| 1. Underground Storage Tanks - Technical Standards | Promulgated |
| 2. Underground Storage Tanks - Financial Standards | In Development |
| 3. Stormwater Management | In Development |
| 4. Asbestos in Schools Rule | Promulgated |
| 5. SARA Title III Requirements | Promulgated |

| Regulations Omitted from the Cost Analysis (due to insufficient data) | |
|---|---|
| **A. Drinking Water** | |
| 1. Wellhead Protection Plan | In Development |
| 2. Pesticides in Groundwater | In Development |
| 3. Disinfection By-Products | In Development |
| **B. Wastewater Treatment** | |
| 1. National Estuary Program | In Development |
| 2. Wetlands Protection Program - 404(c) Permits | Promulgated |
| 3. Nonpoint Source Regulations/Guidance/Mgmt. Plans | In Development |
| 4. Section 304(l) - Toxics in Water Bodies | In Development |
| **C. Solid Waste Disposal** | |
| 1. National Contingency Plan - Superfund Program | In Development |
| 2. Low-Level Radiation Waste Standards | In Development |
| 3. Toxicity Characteristics of Solid and Hazardous Wastes | In Development |
| **D. Miscellaneous Regulations** | |
| 1. Heavy-Duty Diesel Vehicles | Promulgated |
| 2. Gasoline Marketing | In Development |
| 3. Diesel Fuel Standards | In Development |
| 4. Revisions to National Ambient Air Quality Standards (Ozone, Carbon Monoxide, Particulate Matter, Nitrogen Oxides, Sulfur Oxides) | In Development |
| 5. Asbestos in Public Buildings | May Be Required |

costs for four service categories (i.e., drinking water, wastewater treatment, solid waste, and miscellaneous costs) were used in the analysis. The weighted average costs were used to calculate the additional charges to households for environmental services that would be in effect by 1996. These weighted average costs were examined in light of the current revenues and expenditures for environmental services in each municipality in the municipal data base. Taken together, these data bases provide current and future expenses for all environmental services. The change in total charges and fees paid by households to meet the new requirements was used as an indicator of the expected severity of the impact to households. The household burden measure used was the percentage increase in total charges and fees paid relative to current charges and fees. As there is no established limit on what this increase can or should be when addressing the degree of impact to households, the distribution of the municipalities' percentage increases is presented, and several points along the distribution are highlighted.

The study also examined the capability of each municipality to obtain financing for the additional capital expenditures required for the environmental regulations. Three financial mechanisms were addressed - revenue bonds, general obligation (g.o.) bonds, and bank loans (primarily for smaller communities excluded from bond markets).* The first stage of the financial capability analysis considered whether municipalities in the sample would have difficulty issuing a revenue bond to cover the costs of meeting additional drinking water or wastewater treatment system requirements. Their ability to meet the requirements was assumed to be contingent upon the condition that the increase in user charges to households necessary to meet additional EPA requirements will not exceed a given level of the household's gross (pre-tax) annual income. Municipalities that will be required to set user charges at levels that exceed specified ratios of current gross household income (1.0%, 1.25%, and 2.0%) are projected to have potential long-term difficulty issuing a revenue bond to finance the new requirements. Drinking water and wastewater treatment services were examined in this manner because most municipalities operate these services as enterprise units, or independent business units, which are normally supported through user charges and fees.

These thresholds are derived using information on the distribution of current user charges to households for each drinking water and wastewater treatment services. As shown in Figure 2-2, current operations require households pay approximately 0.5% of gross household income for each individual service. The thresholds set separate limits of 1.0%, 1.25%, and 2.0% for each of the drinking water and wastewater treatment services. The 1.25% threshold attempts to address the sensitivity of the results to the selection of a threshold based upon current conditions. The 2.0% threshold -- an approximate doubling of the higher observed current user charges for either drinking water or wastewater treatment in the sample -- is used to present the consequences of using a more relaxed criteria for households user charges.

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* Although municipalities under 2,500 do not normally issue revenue bonds or g.o. bonds, financial institutions will use criteria similar to those used by investment bankers in cases involving larger municipalities. To qualify small systems and municipalities for long-term loans, investment bankers will evaluate performance history, user charges (often as a percent of income), and use revenues from the service as collateral for a loan. Just as in cases where large cities are denied access to revenue bonds and g.o. bonds, so may banks refuse to approve loans to smaller municipalities where their systems or finances do not pass the criteria described in the study.

For example, for a drinking water system to exceed the 1.0% threshold, the addition of new environmental costs to the current costs of supplying drinking water would require that average household user charges be set above 1.0% of the gross household income for the population served by the system. The same approach is followed for each of the three thresholds, and is repeated after calculating the additional environmental costs for wastewater treatment. Therefore, using the 1.0% threshold example, a municipality may find itself facing one of four possible outcomes after calculating new household user charges: (1) both drinking water and wastewater treatment costs fall below the 1.0% threshold; (2) only drinking water costs exceed the 1.0% threshold; (3) only wastewater treatment costs exceed the 1.0% threshold; and (4) both drinking water and wastewater treatment costs exceed the 1.0% threshold. If the municipality was projected to face either of the conditions described in situations (2), (3), or (4), then it was assumed that the relevant drinking water and/or wastewater treatment system would have difficulty raising capital using revenue bonds.

Costs for solid waste and miscellaneous requirements are not included in the revenue bond test due to the limited number of instances that this mechanism has been used with these "non-enterprise" services. Although more local governments are choosing to operate their solid waste services as enterprise systems, the limited number of enterprises in the sample led to the exclusion of solid waste services from the revenue bond section of the analysis.

The second stage of the financial capability analysis introduces the additional costs for solid waste disposal and miscellaneous requirements, and examines the ability of the municipality to use municipality revenues and taxing authority to finance capital requirements. For those municipalities projected to have long-term difficulty issuing revenue bonds for their drinking water and/or wastewater treatment systems, these costs are included with the solid waste and miscellaneous requirements. Where no long-term difficulties are anticipated for the drinking water and wastewater treatment services, only the solid waste and miscellaneous costs are examined against the municipality's revenue base.

The ability of a municipality to issue a g.o. bond was assumed to be contingent upon the municipality's total existing and new environmental debt service obligations relative to two measures: (1) the municipality's 1986 total general revenues, and (2) the municipality's total 1986 market value of assessed taxable property. The first condition measures existing revenue sources, whereas the second condition considers potential revenue sources. A series of threshold values were established using information on the distribution of values for the two measures from the sample of municipalities. The values were used in conjunction with the relevant environmental costs to determine which municipalities would have potential difficulty issuing g.o. bonds (or for smaller municipalities, obtaining a bank loan). A municipality had to exceed the threshold value for both measures before it was assumed to have difficulty using g.o. bonds. It is the number of municipalities having difficulty meeting these conditions that best represent the severity of the financial impacts of the additional EPA regulations considered in this study.

**Limitations**

Many simplifying assumptions necessary to carry out this study limit its accuracy.

The municipal data base consists of a relatively small sample of communities (270), and may not be adequate to form the basis for national estimates. In particular, the analysis may fail to adequately portray the conditions of the smallest of local governments - those under 500 persons. Furthermore, the data base was prepared from fiscal balances for only one year (1986). Because the fiscal conditions of communities continually change with the economy, the data from 1986 may not be representative of the financial conditions that will exist during the 1988-1996 period.

The cost data used in this study were taken from a limited set of EPA regulations. Although about 40 of the 85 regulations considered in the study were identified as having some implications for local government, only 22 were at a stage where cost data were available to be used in the analysis. Several of the omitted new requirements may require significant investments in local government resources (e.g., asbestos in public buildings), or may lead to major changes in current land use patterns (e.g., groundwater protection, nonpoint source guidelines). Furthermore, because some of the regulations included in the study are not yet final, the eventual costs may differ from those estimated in this study. Therefore, the results of this study cannot provide a definitive picture of what local governments will be spending by 1996 to meet EPA requirements. This study only captures a portion of the total picture, and even this portion is subject to change.

In preparing the cost data, it was assumed that small municipalities generally are served by small environmental service systems and large municipalities by large systems. The actual distribution of systems across municipalities may be different, so the costs to households may not be well represented by this method. Furthermore, to reduce the costs of environmental regulations, municipalities may change the way they provide environmental services. Municipalities may enter into regional service agreements in order to take advantage of scale economies, or they may look to private companies or contractors to provide services, thus freeing themselves of sole responsibility for financing the construction of facilities. They may also find it economical to purchase services from adjacent municipalities or special districts, rather than build new systems to supply the services themselves.

The financial indicators used to estimate households' ability to pay increased user fees and municipalities' ability to finance capital expenditures are based upon measures currently used in the financial community, but only until local governments make arrangements to raise fees or initiate bond referendum to finance new construction will the preferences of consumers be known. Consumers may be more or less willing to pay for improved environmental services than these indicators suggest. On the other hand, some municipalities may have to finance a large number of public works other than those included in this study, and consequently may encounter financial constraints even though they are not predicted to exceed the financial indicators used in the study.

## THE IMPACT OF ENVIRONMENTAL REGULATIONS

The study first examined how much municipalities' expenses for environmental services would increase with the additional environmental regulations. These new expenses were then added to recent financial statistics from the 270 sample municipalities to determine whether the increased environmental expenses would cause any of the municipalities to fail the financial indicator tests.

### Environmental Expenses

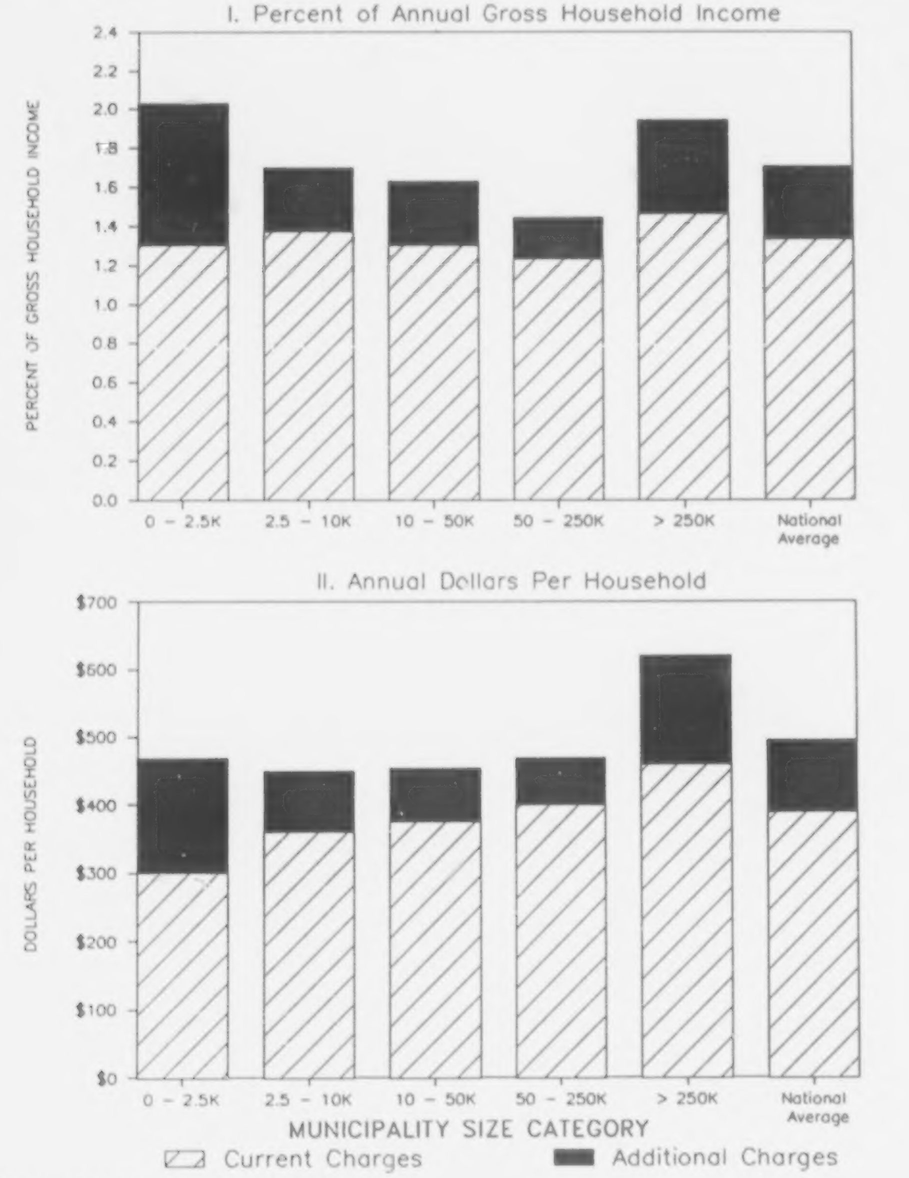
The estimated increases in environmental expenses for households in municipalities in each of five size categories is presented in Figure 2-3, both in terms of dollars per household and percent of household income. The largest potential increase in average annual costs per household will occur in communities under 2,500 persons, which will experience an increase of $170 in their annual costs. The households in communities between 2,500 and 250,000 persons will experience a smaller potential increase of $80 to $90 in their annual expenditures for environmental services. Communities over 250,000 persons may also experience large increases in costs for services. The average potential increase in annual costs for the largest communities is $160. The national average increase in annual household costs is $100.

When expressed as a percentage of household income, the greater relative increase in costs to communities under 2,500 persons is more evident. The average increase will require households in the smallest communities spend an additional 0.7% of gross household income on environmental services. Households in communities between 2,500 and 250,000 persons will spend an additional 0.2% to 0.4% of gross household income. Communities over 250,000 will spend an additional 0.5% of gross household income on environmental services. Although the average dollar increases in communities over 250,000 are comparable to average dollar increases in communities under 2,500, larger communities have higher average household income levels than do smaller communities. The potential national average increase in costs will require that an additional 0.4% of gross household income be spent on improved environmental services. Adding potential additional costs to existing environmental expenses suggests that total future dollar expenditures will be approximately the same for all but the largest municipalities. However, because household income tends to be lower in smaller communities, the percentage of household income devoted to environmental expenses will be greatest in communities under 2,500 persons, followed closely by municipalities over 250,000 persons.

The individual environmental regulations that account for the largest potential increases in expenses in small communities are the drinking water and sewage treatment requirements. Several of the more costly drinking water regulations will apply to a greater proportion of smaller municipalities than larger municipalities. These regulations do not single out smaller municipalities per se, but instead deal with environmental risks that are present at smaller community drinking water systems. Many larger water supply systems already have introduced treatment systems capable of handling some of these risks. This helps to explain why the overall increases for smaller communities exceed those for the larger communities. The costs of solid waste disposal, asbestos removal in schools, and underground storage tank regulations, when totalled, also account for a significant portion of the costs borne by smaller communities. Taken individually, these costs tend to be less

**Figure 2-3**

CURRENT AND POTENTIAL ADDITIONAL AVERAGE ANNUAL HOUSEHOLD COSTS FOR IMPROVED ENVIRONMENTAL SERVICES



Source: Municipal Sector Study Database

than the drinking water and wastewater treatment regulations. However, most municipalities are subject to these requirements, whereas the costlier water regulations affect a smaller proportion of municipalities. As a result, not only do the drinking water regulations lead to relatively large changes in fees in a few municipalities, but the cumulative costs of the other regulations can add up to sizable increases in user charges and fees for some municipalities.

**Increases in Household User Charges - Household Burden Measures**

When the costs of complying with the environmental regulations are added to existing environmental expenses, the user charges and fees of the vast majority of municipalities will increase. Some municipalities may have to raise user fees considerably above current rates. Table 2-2 presents information on the percentage of municipalities that may potentially burden households with requests for large user charge and fee increases. The percentage increases are based on a comparison of current (1986) average charges to households for existing environmental services (i.e., drinking water, wastewater treatment, and solid waste disposal) and potential future (1996) average charges for improved environmental services, once all of the additional regulations examined in the analysis are in-place. Because the study was conducted using average charges and costs of additional regulations to municipalities, the specific requirements for individual municipalities may require that some spend either more or less than the average impact results described in the study.

Most of the municipalities that would experience the largest overall percentage increases in fees are the smallest municipalities. As shown in Table 2-2, the user fees of 20% of the municipalities under 2,500 persons may rise over 100% above current levels by 1996. An additional 35% of these sized communities may find their environmental bills increase between 50% and 100%. None of the municipalities above 2,500 persons in the sample are projected to have their household costs rise by over 100%. Households in 10% of the communities between 2,500 and 10,000 persons and 20% of communities between 10,000 and 50,000 persons may find their expenses increasing between 50% and 100%. All communities in the sample between 50,000 and 250,000 persons are projected to experience less than 50% increases in household expenses for improved environmental services. Approximately 20% of the municipalities above 250,000 persons may require household expenditures rise between 50% and 100%. Although a significant number of larger communities may need to raise household fees between 50% and 100%, most households will not experience large percentage increases in costs of environmental services. Nationally, only 2% of households may have their current environmental service charges and fees rise by more than 100%, and 15% may have to pay between 50% and 100% above their current payments. Many of the households that are expected to experience initial "rate shocks" when confronted with rising user fees are in communities having fewer than 2,500 persons.

The magnitude of the rate increases suggest the extent to which problems may occur, not necessarily where rate increases will be rejected and municipalities will fail to meet required improvements in environmental quality. Efforts to inform voters of the benefits of environmental improvements can play a useful role when faced with households reluctant to accept projected increases in user fees. Furthermore, municipalities may be able to mitigate the increases in household costs by using innovative technologies or alternative methods of supplying services (e.g., regional service arrangements).

## Table 2-2

## POTENTIAL CUMULATIVE IMPACT OF ENVIRONMENTAL REGULATIONS: PERCENT INCREASE IN HOUSEHOLD USER CHARGES

| | | Percent of Municipalities in the Category | | |
|---|---|---|---|---|
| | | Increase as a Percent of Current Charges* | | |
| Municipality Size Category | Number of Municipalities | 0 - 50% | 50 - 100% | > 100% |
| 0 - 2,500 | 26,315 | 45% | 35% | 20% |
| 2,500 - 10,000 | 6,279 | 90 | 10 | 0 |
| 10,000 - 50,000 | 2,694 | 80 | 20 | 0 |
| 50,000 - 250,000 | 463 | 100 | 0 | 0 |
| > 250,000 | 59 | 80 | 20 | 0 |
| Percent of Municipalities | | 56% | 29% | 15% |
| Percent of Population** | | 83% | 15% | 2% |

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[*] This percent increase is calculated as follows:

$$\frac{\text{(Additional Drinking Water + Wastewater + Solid Waste + Miscellaneous Costs)}}{\text{(Current Drinking Water + Wastewater + Solid Waste Costs)}} \times 100$$

[**] Percent of U.S. population living in municipalities and townships within each municipality size category. According to the 1982 Census of Governments, approximately 85% of U.S. population resides in these government organizations. Distribution is: 0-2,500 (10%); 2,500-10,000 (16%); 10,000-50,000 (29%); 50,000-250,000 (23%); > 250,000 (22%).

**Capital Financing Indicators**

Table 2-3 presents the percent of municipalities that may have long-term difficulties raising funds with revenue bonds because of the eventual household rates that must be charged to meet existing and potential EPA requirements. The drinking water and wastewater systems were examined using three different threshold values- -- 1.0%, 1.25%, and 2.0% of gross household income. The two lower thresholds represent an effective doubling of average current user charges for each of these improved services. The 2.0% threshold -- an amount not currently expended in any municipality in the sample -- represents a more relaxed criteria of user charges expended for these services.

Some systems currently have user charges in-place that exceed the lower two income thresholds. The numbers in brackets in Table 2-3 show the estimated percentage of systems that exceed the thresholds prior to adding the costs of additional environmental requirements. These systems, as well as systems charging households rates below the thresholds, may need to raise rates further if subject to the additional requirements. Their current conditions may lead to different difficulties in obtaining financing from systems presently below the financial thresholds, and suggest different solutions may be necessary to meet their financial needs. The numbers show that a greater percentage of systems serving communities under 2,500 persons presently exceed the 1.0% and 1.25% thresholds than do systems in larger communities. These circumstances have already led EPA to initiate several programs to assist smaller communities seeking to meet environmental objectives. Several of these programs are discussed in Chapter 5.

As shown in Table 2-3, if a 1.0% threshold is used for each individual service, approximately 26% (21% above the 5% baseline failure rate) of the drinking water or wastewater systems in municipalities under 2,500 persons may have difficulties in revenue bond markets. Raising the threshold up to 1.25% of household income reduces this to 12% (10% above the 2% baseline failure rate) of systems in municipalities under 2,500 persons, and raising the threshold up to 2.0% reduces the failure rate down to 2% of systems. Larger municipality size categories will have less difficulty meeting the additional requirements. Using the 1.0% threshold measure, between 4% and 8% of the systems in municipalities with 2,500 to 250,000 persons may have difficulty in the revenue bond markets. Raising the threshold to 1.25% decreases the percent of systems failing the test to 2%. No systems in the sample serving more than 2,500 persons fail the 2.0% threshold, because none of these systems are expected to raise rates above 2.0% of gross household income.

A greater percentage of systems in municipalities over 250,000 may experience difficulties at the 1.0% threshold (11%, or 7% above the 4% baseline failure rate), but this number falls to 3% when using the 1.25% threshold, and down to zero for the 2.0% threshold. For the nation, 21% (15% above the 6% baseline failure rate) of drinking water and wastewater treatment systems may have difficulty using revenue bonds/loans when using the 1.0% threshold. The number drops to 9% (8% above the 1% baseline rate) of systems when using the 1.25% threshold, and less than 1% using the 2.0% threshold. Because most of the municipalities projected to have difficulties are small in size, the percent of persons residing in municipalities that may face each of the income thresholds is relatively smaller than the number of municipalities failing the criteria (e.g., 9 percent of households exceed the 1.0% threshold, contrasted against 21% of the municipalities).

## Table 2-3

## POTENTIAL IMPACT OF ENVIRONMENTAL REGULATIONS ON THE ABILITY OF DRINKING WATER AND WASTEWATER TREATMENT SYSTEMS TO ISSUE REVENUE BONDS/OBTAIN BANK LOANS IN THE LONG TERM[*]

| | | Percent of Municipalities Whose Systems May Be Unable to Issue Revenue Bonds/Obtain Loans in the Long Term | | |
|---|---|---|---|---|
| **Municipality Size Category** | **Number of Municipalities** | **User Charge/ Household Income > 1.0%** | **User Charge/ Household Income > 1.25%** | **User Charge/ Household Income > 2.0%** |
| 0 - 2,500[**] | 26,315 | 26%<br>[5%][***] | 12%<br>[2%] | 2%<br>[0%] |
| 2,500 - 10,000 | 6,279 | 8<br>[2] | 2<br>[1] | 0<br>[0] |
| 10,000 - 50,000 | 2,694 | 7<br>[3] | 2<br>[1] | 0<br>[0] |
| 50,000 - 250,000 | 463 | 4<br>[4] | 0<br>[0] | 0<br>[0] |
| > 250,000 | 59 | 11<br>[4] | 3<br>[0] | 0<br>[0] |
| Percent of Municipalities | | 21% [4%] | 9% [1%] | < 1% [0%] |
| Percent of Population[****] | | 9% | 3% | < 1% |

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[*] Long Term Revenue Bond/Loan Criteria for Drinking Water and Wastewater Services. Percent of municipalities whose new user charges for either one of the services is greater than the stated threshold value (either 1.0%, 1.25%, or 2.0% of gross household income). The model examines the financial capability of each service separately. For example, the results in the 1.0% column refers to the results of imposing a 1.0% threshold on drinking water and a 1.0% threshold on wastewater treatment services. A municipality effectively fails the threshold test if either one or both of the drinking water and wastewater treatment systems fails the 1.0% threshold. The sum of each individual service is not examined in the study because a significant number of municipalities operate these two services as separate enterprise units. For more information on thresholds, see Municipal Sector Study report.

[**] Smaller municipalities (under 2,500 persons) generally do not issue revenue bonds. Instead they obtain bank loans backed by user charges. The criteria used in the revenue bond tests can be applied to these smaller municipalities.

[***] Percent of systems exceeding the threshold prior to incurring potential costs of additional requirements (baseline systems failing the criteria).

[****] Percent of U.S. population living in municipalities and townships within each municipality size category. According to the 1982 Census of Governments, approximately 85% of U.S. population resides in these government organizations. Distribution is: 0-2,500 (10%); 2,500-10,000 (16%); 10,000-50,000 (29%); 50,000-250,000 (23%); > 250,000 (22%).

The final stage of the financial analysis takes the information from the revenue bond test and combines it with information on solid waste and miscellaneous expenses to determine if the general revenues and taxing authority of the municipality can be used to finance the additional costs to non-enterprise services and, if necessary, the enterprise services. As shown in Table 2-4, the municipalities expected to have the greatest difficulty using g.o. bonds and loans to finance additional environmental requirements are in the smaller size categories. The small municipalities will have greater difficulties meeting the solid waste and miscellaneous EPA requirements, particularly in those instances where the drinking water or wastewater system costs must also rely upon the municipality's revenue base to raise funds. Using the two different tests, between 21% and 30% of municipalities under 2,500 persons may have difficulty financing the additional EPA requirements using both revenue and g.o. bonds. The table shows that 4% to 9% of municipalities between 2,500 and 10,000 persons, and 2% to 6% of municipalities between 10,000 and 50,000 persons may have difficulty obtaining capital financing for the cumulative set of EPA requirements. Municipalities over 50,000 persons are expected to have no difficulty obtaining financing for their projected requirements.

Although omitted from the presentation in Table 2-4, the different revenue bond threshold values do not appear to play an important role in determining whether the municipality can meet its financial requirements. Using a threshold of 1.0% versus 1.25% for drinking water or wastewater treatment costs does not significantly change the number of municipalities expected to face financial difficulties. Although the selection of the income threshold in Table 2-3 significantly altered the number of systems failing the revenue bond test, the g.o. bond test results are most affected by the current financial conditions of the municipality. The information in brackets in Table 2-4 show the estimated number of municipalities exceeding the thresholds prior to adding additional environmental requirements. As many as 8% of the municipalities under 2,500 persons fail the criteria in Test I, and 12% fail the criteria using Test II. Small municipalities that have already committed themselves to large capital projects for environmental or other infrastructure needs may have to complete these projects prior to investing in new projects. Nevertheless, they will face additional costs and increasing demands on their current financial base.

In addition to the number of financially weak communities, some small municipalities currently in good financial shape may be pushed beyond the criteria. The costs of some individual requirements, or the cumulative costs of several requirements that must be met within a short period of time, may strain the financial capability of several small communities. The large increases in costs for environmental services in small municipalities may result in a significant proportion of these municipalities -- between 13% and 18% -- having financial difficulty meeting the additional EPA requirements for improved environmental services. The cumulative results indicate that between 21% and 30% of the communities in the sample under 2,500 persons may have difficulty financing the requirements.

The numbers in Table 2-4 indicate that the percentage of communities with more than 2,500 persons failing the baseline is not noticeably different from the percentage of municipalities failing the criteria after adding the costs of the additional requirements. These results suggest that the financially weaker municipalities above 2,500 persons are likely to face financial constraints, but the other communities that have sufficient financial latitude may have little difficulty meeting

### Table 2-4

### POTENTIAL IMPACT OF ENVIRONMENTAL REGULATIONS ON THE ABILITY OF MUNICIPALITIES TO ISSUE GENERAL OBLIGATION BONDS/OBTAIN BANK LOANS

| | | Percent of Municipalities That May Fail to Issue G.O. Bonds/Obtain Loans in Each Size Category* | |
|---|---|---|---|
| Municipality Size Category | Number of Municipalities | G.O. Bond/Bank Loan Test I | G.O. Bond/Bank Loan Test II |
| 0 - 2,500*** | 26,315 | 21%<br>[8%]**** | 30%<br>[12%] |
| 2,500 - 10,000 | 6,729 | 4<br>[3] | 9<br>[9] |
| 10,000 - 50,000 | 2,694 | 2<br>[0] | 6<br>[6] |
| 50,000 - 250,000 | 463 | 0<br>[0] | 0<br>[0] |
| > 250,000 | 59 | 0<br>[0] | 0<br>[0] |
| Percent of Municipalities | | 16% [7%] | 24% [11%] |
| Percent of Population**** | | 3% | 6% |

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[*] Combined G.O. Bond/Loan and Revenue Bond/Loan Thresholds: Solid waste and miscellaneous regulatory capital costs are always examined. The capital costs of drinking water and/or wastewater system requirements are included in calculating required new debt service (total capital costs) if the 1.0% Revenue Bond/Loan Threshold for either system has been exceeded. For more information on thresholds, see Municipal Sector Study report.

G.O. Bond/Loan Thresholds - percent of municipalities exceeding both of the following: (i) Current annual debt service plus new debt service expressed as a percent of current annual municipality revenues: (Test I: 20%), (Test II: 15%). (ii) Current annual debt service plus new debt service expressed as a percent of the market value of taxable property: (Test I: 0.8%), (Test II: 0.6%). Results using 1.25% and 2.0% threshold are not included because they are not significantly different from results using 1.0% threshold.

[**] Smaller municipalities (under 2,500 persons) generally do not issue revenue bonds or g.o. bonds. Instead they obtain bank loans that are backed by user charges. The criteria used in the two bond tests can still be applied to these smaller municipalities.

[***] Percent of municipalities exceeding the threshold prior to incurring potential costs of additional requirements (Baseline municipalities failing criteria).

[****] Percent of U.S. population living in municipalities and townships within each municipality size category. According to the 1982 Census of Governments, approximately 85% of U.S. population resides in these government organizations. Distribution is: 0-2,500 (10%); 2,500-10,000 (16%); 10,000-50,000 (29%); 50,000-250,000 (23%); > 250,000 (22%).

additional EPA requirements. This conclusion is, in part, contingent upon the willingness of the community to support its local drinking water or wastewater treatment systems. If the community should choose not to assist financially constrained drinking water or wastewater treatment system operations, then the number of larger systems and communities failing to obtain financing for additional environmental requirements may fall between the numbers presented in the revenue bond results of Table 2-3 and the g.o. bond results of Table 2-4.

## CONCLUSION

The major findings of this study may be summarized as follows:

### Household Impacts

The potential cumulative cost of regulations examined in the study that improve environmental services provided by municipalities may require that the national average household spend an additional $100 per year by 1996.

Both municipalities under 2,500 persons and over 250,000 persons will experience the largest average increases in total user charges and fees paid on a per household basis. The average potential increase in user charges and fees will be $170 and $160, respectively. Some of the more costly regulations address technologies that are in operation at most large municipalities, but have yet to be adopted by small municipalities. Also, costs per household for many regulations tend to fall as the population increases, due to economies of scale. These conditions, plus the lower average household income levels in smaller municipalities, will require that households in communities under 2,500 persons pay a greater proportion (0.7%) of their income, on average, for these services than households in larger municipalities (0.5%).

### Financial Impacts

Most municipalities will be able to meet the expected increases in environmental expenses and still remain financially sound. The municipalities most likely to experience difficulty will be the municipalities with populations of 2,500 or less. Between 21% and 30% of the communities under 2,500 persons may have difficulty using revenue bonds, g.o. bonds, and loans because of the high cost of some individual regulations and the cumulative costs of recent legislative requirements (affecting between 13% and 18% of small municipalities), and the limited margin for expanding financial obligations in small communities due to existing demands for environmental and other infrastructure services (the remaining 8% to 12% of small municipalities).

These difficulties are not limited to small municipalities, but the results suggest that a much smaller proportion of the municipalities over 2,500 persons will face financial constraints when subject to additional EPA requirements. Unlike the small municipalities, most of the constrained municipalities already are in financially weak positions, given the criteria. The additional environmental requirements, on average, should not place financially strong communities into weak financial positions.

Some portion of enterprise systems serving larger municipalities, particularly those over 250,000 persons, may have difficulties financing their additional requirements. If the municipalities served by these systems fail to offer support to finance some portion of the requirements, these systems and municipalities may have difficulty meeting the additional capital requirements.

Because of the many simplifying assumptions required to carry out this study, care should be taken in interpreting the results. The municipal government sample database requires that caution be exercised when seeking to extrapolate results to the nation as a whole, particularly for very small systems and communities. Several of the regulations considered are not yet final, so their costs may change. Regulations likely to be important for municipalities and households were not included in the cost analysis because of insufficient information on costs and number of affected communities. Their omission may result in an underestimate of the costs to affected municipalities. On the other hand, municipalities may be able to undertake alternative means of meeting environmental objectives that are less costly than original EPA estimates.

The analysis underscores EPA's efforts to seek additional information on the finances and environmental options available for smaller municipalities. Knowing more about individual community requirements will assist EPA in better designing and modifying programs capable of dealing with their unique problems. This information may be of most value for smaller communities, as they face the potentially greatest challenges in the coming decade.

## Chapter 3

## SMALL BUSINESS

The United States is a nation of small businesses as much as it is a nation of large corporations. Over ninety-five percent of all businesses have fewer than 50 employees. Although these firms employ only about one quarter of the people in the United States and account for about one quarter of total sales, they are an important part of the economy and an integral part of the American way of life.

While environmental regulations affect all businesses, small businesses have their own special problems in dealing with them. Firms with only 5 or 10 employees do not have the financial resources or the legal and engineering staffs available to larger firms. Often their costs per unit of production to comply with environmental regulations are much larger than those of their large competitors.

From its inception in 1970, EPA has recognized the special problems of small businesses in dealing with environmental regulations and has taken these problems into account in its rulemaking process. Often, EPA has relaxed some environmental regulations for small businesses and, for some regulations, has exempted small businesses. EPA's Small Business Ombudsman has been appointed to represent the special needs of small businesses within the Agency.

This study* investigates the potential impact upon small businesses of the environmental regulations that will have the most effect from 1988 through 1992. The study first examines how these regulations will affect small businesses in general, and then examines in more detail the impacts upon selected industries.

### SMALL BUSINESS AND ENVIRONMENTAL REGULATIONS

Although it might seem that EPA's 85 regulations would overwhelm any small business, the actual impacts will vary greatly. Many small businesses will not be affected directly by any of the 85 regulations. Some firms will be affected adversely by the regulations, but others -- particularly those that provide pollution control products or services -- will find that their businesses grow. Thus, the overall impact of EPA's forthcoming regulations is by no means self-evident.

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* The Small Business Sector Study: Impacts of Environmental Regulations on Small Business; prepared for the U.S. Environmental Protection Agency, Office of Policy, Planning and Evaluation by Lyman H. Clark and E. H. Pechan & Associates, Inc.; September 1988.

Whether a small business is affected by many environmental regulations, only one regulation, or none at all depends upon whether the business contributes to environmental problems or helps to solve them. Most small businesses - for example, those in the wholesale, retail, financial, and services sectors - are relatively neutral as regards environmental problems and, hence, are not directly affected by any environmental regulations. These sectors of the economy include 70% of all small businesses.

Small businesses are adversely affected by environmental regulations when they create environmental problems that the nation has decided to address. Traditionally, the businesses associated with environmental problems have been those in the "smokestack" industries, such as mining and manufacturing -- industries that discharge pollutants into the air or waterways. The businesses adversely affected by the new regulations are those that use toxic chemicals in their processes or generate hazardous wastes. These include some industries that usually are considered to be polluting industries -- petroleum refiners, iron foundries, and electric utilities -- and other industries that generally are not regarded as polluters -- dry cleaners, gasoline service stations, and farm supply stores.

Because one firm's expenditure to comply with an environmental regulation is often another firm's receipt, many small businesses will find that the forthcoming environmental regulations create an increased demand for their products and services. Small businesses that provide engineering or laboratory services, for example, or manufacture pollution control or monitoring equipment, or clean up hazardous waste sites should be positively affected by the new environmental programs. Although this study does not examine these positive impacts, they are worthy of note as part of the total economic picture.

A list of the industries that could be either negatively or positively affected by EPA's regulations was prepared as part of the small business sector study and is presented therein. While this list is not exhaustive and was prepared using information that, in many cases, was still preliminary, it provides a representative picture of the kinds of industries that are most likely to be affected, either adversely or positively. Those industries listed most frequently as potentially adversely affected by the environmental regulations are examined in Table 3-1. They include about 3.5% of all small businesses in the United States.

Although firms with fewer than 50 employees account for 95% of all businesses, the relative importance of small businesses varies from sector to sector. Firms with fewer than 50 employees account for over half the employment and sales in some sectors - agriculture, construction, and wholesale trade - but less than 20 percent of employment and sales in other sectors - mining, manufacturing, and transportation. Thus, some sectors of the economy can be said to be "small business dominated," and others can be said to be "large business dominated." Several of the industries listed in Table 3-1 are clearly small business dominated.

### Table 3-1

## SMALL BUSINESSES* IN SELECTED INDUSTRIES - 1986

| | | Number of | Number of Small | Small Business Portion of | | |
|---|---|---|---|---|---|---|
| SIC | Industry | Firms | Businesses | Firms | Employment | Sales |
| 2491 | Wood Preserving | 344 | 309 | 90% | 49% | 54% |
| 2861 | Gum & Wood Chemicals | 70 | 61 | 87% | 4% | 18% |
| 2879 | Pesticide Formulators | 338 | 307 | 91% | 13% | 14% |
| 2911 | Petroleum Refining | 315 | 241 | 77% | 1% | 5% |
| 3292 | Asbestos Products | 114 | 91 | 80% | 4% | 3% |
| 3321 | Gray Iron Foundries | 602 | 370 | 62% | 10% | 11% |
| 3341 | Secondary Smelting | 506 | 435 | 86% | 25% | 25% |
| 3471 | Electroplating | 3,350 | 3,050 | 91% | 56% | 51% |
| 4213 | Interstate Trucking | 24,608 | 22,656 | 92% | 27% | 30% |
| 4911 | Electric Utilities | 1,376 | 864 | 62% | 4% | 4% |
| 4941 | Water Supply | 2,109 | 1,977 | 94% | 32% | 28% |
| 4953 | Refuse Systems | 2,868 | 2,742 | 96% | 31% | 30% |
| 5191 | Farm Supply Stores | 15,810 | 15,609 | 99% | 66% | 65% |
| 5541 | Service Stations | 54,930 | 54,077 | 98% | 71% | 62% |
| 7216 | Dry Cleaners | 15,728 | 15,438 | 98% | 79% | 79% |
| 7395 | Photofinishing Labs | 4,739 | 4,547 | 96% | 42% | 47% |

* Includes businesses with 1-49 employees.

Source: U.S. Small Business Administration: Small Business Data Base (SBDB), United States Establishment and Enterprise Microdata (USEEM).

## STUDY METHODOLOGY AND LIMITATIONS

Because the number and diversity of small businesses make it impossible to cover all small businesses in this study, the study focuses upon describing the impact of the environmental regulations upon representative small businesses in nine selected industries. The methodology has been designed to describe the environmental regulations that different types of industries will face and to provide a preliminary indication of how the costs of these regulations will compare to the financial capabilities of small businesses in each industry. This methodology necessarily limits the detail of the analysis and the accuracy of the results.

### Methodology

The first step in this study was to examine the list of 85 environmental regulations to determine which industries would be most affected. These industries were then examined to determine which would be most appropriate for further study. Table 3-1 lists those industries that were found to be most affected by the environmental regulations and presents statistics on the relative importance of small businesses in each industry. Several of the industries listed in Table 3-1 were selected for further study because they have a high percentage of employment or sales accounted for by small businesses: dry cleaning, gasoline service stations, farm supply stores, electroplating, wood preserving, and photofinishing laboratories. Although small businesses do not account for a high portion of employment or sales in the interstate trucking industry, this industry was selected simply because it includes such a large number of small businesses. Two other industries, pesticide formulators and water supply companies, were selected because their environmental problems are different from those of most of the other industries on the list.

Definitions of a "small business" vary. The U.S. Small Business Administration (SBA) uses different definitions for each industrial category. For most manufacturing industries, SBA defines a small business as a firm with fewer than 500 employees (99.6% of all firms). The U.S. Occupational Safety and Health Administration (OSHA), on the other hand, defines a small business as a firm with fewer than 10 employees (75.4% of all firms). Most of the statistics presented in this sector study focus on businesses with fewer than 50 employees (95.3% of all firms). While this definition is somewhat arbitrary, it in no way affects the conclusions of the study. Whatever the definition used, most businesses are small, and the number of small businesses is about 3.5 million.

The approach used in analyzing each of these industries selected may be outlined as follows:

1. Describe a "typical" small business in the industry.

2. Identify the environmental "problems" associated with small businesses in the industry.

3. Identify the environmental regulations that will apply to these small businesses, and estimate the associated compliance costs.

4. Estimate the paperwork costs associated with the environmental requirements for each industry.

5. Compare the estimated compliance costs, including the paperwork burden, with industry financial statistics to determine whether small businesses might be expected to have difficulty meeting environmental requirements. Where the estimated annual cost of compliance was found to exceed 30% of net profits and/or where the estimated capital costs were found to exceed 30% of equity, then small businesses in the industry were identified as having the potential for financial difficulties.

The threshold value of 30% was selected on more or less an arbitrary basis. Time and data limitations prevented any extensive financial modeling or detailed analysis of potential business impacts. This study was designed, instead, to identify potential problem areas. When estimated environmental costs exceed 30% of the median small business's annual net profits and/or estimated capital costs exceed 30% of the median equity, then there seems to be cause for concern. Small businesses in some industries may be able to pass such costs on to their customers and others may be able to reduce the costs through innovative techniques. Some of the costs will be absorbed by reduced taxes. There are a variety of ways that businesses may adjust to increased costs. Nevertheless, when it appears that increased costs in any size category of any industry may exceed 30% of profits, it is safe to say that the potential for financial difficulties exists. Because the study examined the financial statistics of both the median firm in each size category and the firm at the lowest quartile level, the results of the analysis are not particularly sensitive to the 30% threshold value. When costs were close to 30% for the median firm, they were well in excess of 30% for the firm at the lowest quartile.

This study did not address the issue of whether small businesses will be able to pass increased environmental costs on to their customers in the form of higher prices. While economic theory suggests that prices in an industry should rise to reflect producers' costs, such adjustments may take time and may be inhibited by competition from substitute or imported products or simply by consumer resistance. Furthermore, the increased costs experienced by small businesses may be greater than industry averages. Predicting the price increases that might result from increased environmental costs is a complex exercise that is beyond the scope of this study.

Exceptions to the general methodology were made for two industries: gasoline service stations and private water supply systems. The analysis of gasoline service stations was based upon a financial model developed for EPA's Office of Underground Storage Tanks. The analysis of private water supply systems was provided by EPA's Office of Drinking Water based upon its surveys of water supply systems.

For information on the financial condition of small businesses, this study used the 1976-1983 Fin/Stat file compiled by the SBA. This is the only data base that provides separate statistics for many different sizes of businesses, including those that have fewer than 10 employees. Because the estimates of environmental costs often were available only for an "average" small business, it was not possible to conduct detailed financial analyses on businesses of each size category. Using the

Fin/Stat file made it possible, however, to examine the financial capabilities of firms of different sizes and to identify potential problem areas.

Although 1976-1983 financial data is slightly outdated, inflation from 1983 to the end of 1987 was relatively low, about 16%. This is well within the range of accuracy of the other data used in the study and within the normal year-to-year fluctuations in the Fin/Stat data. The average (median) dry cleaner in the Fin/Stat file had lower net profits in 1983 ($12,000) than in 1977 ($14,900), for example, even though the inflation over that period was almost 64%.

**Limitations**

The approach used in this study has several limitations. For example:

1. Many of the regulations included in the study are not yet final. One of the major environmental regulations affecting electroplaters -- for example, the hexavalent chromium air emission standard -- is not available yet in even a preliminary form, and one of the regulations affecting dry cleaners -- the perchloroethylene air emission standard -- is still under formulation with many options under study. Thus, the eventual costs and impacts of many regulations may vary considerably from those indicated herein.

2. The performances of individual small businesses differ considerably from industry averages. Although this study attempts to take this into account in a qualitative way, the study cannot go so far as to say how many small businesses might experience difficulties in any industry.

3. The data used in the study, including both the estimates of environmental costs and the business financial statistics, are of limited accuracy. Thus, the conclusions must be regarded as preliminary.

In spite of these unavoidable limitations, the study provides an initial description of how environmental regulations will affect small businesses and identifies many potential policy issues and problem areas for further study.

## IMPACTS UPON SELECTED INDUSTRIES

Table 3-2 summarizes the results of the industry analyses. The study found that costs may be high for most small businesses in three of the industries--electroplating, wood preserving, and pesticide formulating and packaging. If costs prove to be as high as estimated and cannot be passed on to consumers, some of these small businesses may be forced to discontinue part of their operations or to close. Costs also may be high for small businesses in certain segments of five other industries. Some small dry cleaners that have underground storage tanks or require substantial perchloroethylene emissions controls may have difficulty meeting

Table 3-2

## SUMMARY OF IMPACTS UPON SELECTED INDUSTRIES

| Industry | Most Significant Regulations | Firms That Might Experience Difficulty |
|---|---|---|
| Electroplating | Toxic Chemicals<br>Hazardous Waste<br>Chromium Emissions* | Firms with 1-49 employees |
| Wood Preserving | Hazardous Waste<br>Toxic Chemicals<br>Corrective Action<br>Stormwater Control* | Firms with 1-49 employees |
| Pesticide Formulating and Packaging | Toxic Chemicals<br>Hazardous Waste | Firms with 10-19 employees |
| Farm Supply Stores | Pesticides<br>UST Standards<br>UST Corrective Action | Firms with leaking underground storage tanks |
| Interstate Trucking | UST Standards<br>UST Corrective Action | Firms with leaking underground storage tanks |
| Gasoline Service Stations | UST Standards<br>UST Corrective Action<br>Hazardous Waste | Firms with leaking underground storage tanks |
| Dry Cleaning | UST Standards<br>UST Corrective Action<br>Hazardous Waste<br>Perc Emissions* | Firms with 1-9 employees that have USTs or require perc emissions controls |
| Photofinishing Laboratories | None | None |
| Water Supply | Drinking Water Standards | Firms that serve fewer than 2,500 people |

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* These regulations are still being formulated.

environmental requirements. In addition, certain gas stations, trucking firms, and farm supply stores with leaking underground storage tanks may face corrective action costs beyond their financial means. Small private water supply companies are in a unique position, in that they operate as utilities and generally obtain rate increases to cover their increased costs. While these firms would not be expected to go out of business, high treatment costs for water supply companies that fail to meet new drinking water standards may necessitate large increases in household usage fees. Environmental costs for one of the industries studied -- photofinishing laboratories -- were found to be negligible.

The environmental regulations that appear to be most often responsible for high costs in the industries studied are those covering the handling and reporting of toxic chemicals; the handling, treatment, and disposal of hazardous wastes; and the operation of underground storage tanks. Although costs estimates are available for only some of these regulations, those that are available indicate that the regulations will affect a large number of firms in many industries and may entail costs in the $5,000 to $10,000 range. While these costs may be managed easily by small businesses of moderate size, they present difficulties for the smallest of the small businesses. It is these very small businesses that comprise the majority of U.S. businesses.

The following sections briefly describe the results of the analyses for each industry.

**Electroplating**

The electroplating process requires the use of many toxic and hazardous materials, such as metals and solvents. Although electroplaters generally reclaim and recycle these materials, many of which are valuable, some of the toxic materials remain in electroplating wastewaters and solid wastes. In addition to these problems associated with hazardous wastes, electroplaters that use chromium may also have a problem with hazardous air emissions.

Most of the environmental expenditures for electroplaters over the next few years will have to do with handling and disposing of the sludge that is generated by these wastewater treatment systems and with the recordkeeping and reporting that will become a necessary part of handling toxic substances and hazardous wastes. One other potential expenditure -- emission controls for hexavalent chromium -- will apply only to the chrome plating segment of the industry.

Because electroplaters with fewer than 10 employees will be exempt from Section 313 of SARA Title III, their additional costs for the 1988-1992 period will be approximately $4,430 per year, with an additional cost of approximately $3,680 in the first year for the hazardous waste generator regulations. The estimated annual costs amount to about 32% of the median small electroplater's net profit and the additional first year costs amount to about 7% of their equity. Electroplaters at the lowest quartile of this size category averaged net profits of only $3,400 over the 1976-1983 period and lost $9,100 in 1983. Although the additional first year expenses amount to only 15% of their equity, the $4,430 in additional environmental expenses amounts to 130% of their net profits over the 1976-1983 period. These figures suggest that the electroplaters in this size category may experience difficulty managing the increased environmental costs. Because the $4,430 in annual expenses represents only about 2% of their average sales, it seems probable that many of these electroplaters will be able to adjust to the increased costs, but for some marginal electroplaters the additional expenses could present financial difficulties.

The relative impact of environmental regulations during the 1988-1992 period will be greatest on electroplaters with 10-19 employees. These are the smallest electroplaters that will be subject to Section 313 of SARA Title III. Section 313 may add $9,000 to these electroplater's annual costs, with an additional $3,000 in the first year. This $9,000 plus $4,430 of other expenses amounts to over 70% of the median electroplater's 1976-1983 net profits. Electroplaters at the lowest quartile in this size category averaged net profits of only $3,400 over the 1976-1983 period and lost $4,300 in 1983. The estimated environmental costs would amount to almost 400% of their average net profits. These figures suggest that many electroplaters with 10-19 employees will have difficulty meeting the costs of the environmental regulations.

Electroplaters in the next size category, 20-49 employees, may also experience some difficulty meeting the environmental requirements. Their costs will be approximately the same as those of the smaller electroplaters, and even though they have a larger annual profits, the annual costs are still relatively high. The median electroplater in this size category had net profits over 1976-1983 of $34,000 on equity of $228,000. The estimated annual environmental expenses of $13,430 amounts to 40% of their average 1976-1983 net profits. Electroplaters at the lowest quartile level averaged net profits of only $9,000 over 1976-1983 and experienced a $15,200 loss in 1983. The estimated environmental costs amount to almost 150% of their average net profits. Thus, some electroplaters in this size category also may have difficulty meeting the environmental requirements.

It is only in the next largest size category of 50-99 employees that the environmental expenses amount to less than 30% of the median electroplaters' net profits ($70,000). The electroplaters in the lowest quartile averaged net profits of $40,000, however, so that the estimated environmental costs amount to approximately 34% of these electroplater's annual net profits. Thus, the increased expenses will be high for some of the firms even in this larger size category.

### Wood Preserving

Almost all of the substances and chemicals used at a wood preserving facility are considered toxic or hazardous. In previous years, as the industry was developing, and environmental concerns were not an issue, the practices of many wood preserving facilities eventually contributed to serious contamination of the surrounding area's soil and water. Many of these facilities have had to implement extensive cleanup operations to correct these problems. The cleanup costs have strained the financial resources of many firms severely, and several firms have gone bankrupt.

Over the period 1988-1992, the cleanup of wood preserving facilities will continue, and wood preservers will be faced with new regulations governing the disposal of their hazardous wastes, the reporting of toxic chemicals, and the control of stormwater flows. The problems associated with these new regulations may involve not only increased costs, but also the unavailability of disposal sites. Wood preservers now are finding that there are no disposal alternatives available for their pentachlorophenol wastes.

Management and reporting of hazardous wastes and toxic chemicals will add approximately $14,300 in annual costs to wood preservers' environmental expenses. These costs amount to about 32% of the 1976-1983 median net profits for wood preservers in both the 10-19 and 20-49 employee size category, and over four times the reported 1983 net profits. In addition to these costs, some potentially large costs of forthcoming waste disposal regulations and potentially large capital costs associated with waste-minimizing technologies have not been included in the estimates. These figures all suggest that some wood preservers may have great difficulty meeting environmental expenses.

In addition to these increased annual costs, wood preservers may incur major construction costs to control stormwater. Although these regulations are still in the formative stages, the costs of some of the principal regulatory alternatives, such as constructing roofs or wastewater collection systems for storage yards, have been estimated to be $200,000 even for small facilities. Capital costs of this magnitude amount to 150% of the median equity of wood preservers with fewer than 10 employees, and about 80% of the median equity of those with 10-19 employees. Should costs prove to be as high as the preliminary estimates indicate, small wood preservers would find it very difficult to meet these requirements.

### Pesticide Formulating and Packaging

Pesticide formulating and packaging (PFP) firms handle many materials that are considered toxic and may present an environmental danger if spilled. Similarly, many of the wastes generated from PFP processes are considered hazardous. Process wastewaters from PFP firms may be contaminated with the toxic substances used and/or with the hazardous wastes generated. Finally, the pesticides produced by these firms are themselves dangerous and subject to stringent labeling and handling requirements.

The environmental regulations that will affect PFP firms directly during the period 1988-1992 include those concerned with the handling of toxic substances and hazardous wastes as well as those governing the handling and labeling of pesticides. The PFP plants that currently discharge wastewaters into municipal sewers also will be subject to categorical pretreatment standards at some time in the future.

The smallest PFP firms, those with 1-9 employees, will be exempt from the most costly regulation, Section 313 of SARA Title III, and will have annual costs of only $2,560. These firms should have no difficulty meeting environmental requirements. PFP firms with 10 or more employees will have to comply with Section 313 of SARA Title III and will face costs of $11,560 per year plus increased waste disposal costs and an additional $6,680 in the first year of regulation. They also may have to replace some of their labels at a cost of $1,000-$2,000 each. Although the capital costs are relatively low, the annual costs are about 37% of median net profits of PFP firms with 10-19 employees, and about 200% of the net profits of firms at the lowest quartile level. These figures suggest that some PFP firms with 10-19 employees may have difficulty meeting the requirements. Unlike firms in other industries, small PFP firms may have the option of discontinuing some of their operations rather than closing, if they cannot afford to meet these environmental requirements.

PFP firms will be subject not only to the current and forthcoming regulations that are covered in this study, but also to the continuation of and possible changes in the many existing regulations that govern the manufacture, distribution, and use of pesticides. Firms in the pesticide industry are subject to many environmental product regulations as well as regulations governing the discharge and disposal of residuals. Regulations governing the registration and labeling of pesticides, for example, already are a major factor in the PFP industry. EPA is considering changing many of these existing regulations, which may have a more profound effect on the PFP industry than the regulations covered in this study.

### Farm Supply Stores

Many farm supply stores handle pesticides, with the resultant environmental dangers in possible spillage. For those firms that offer pesticide application services, the mixing and use of these pesticides require stringent handling procedures so as not to contaminate the environment. In addition, those farm supply stores that provide fuels are concerned with potential spills and leaks from underground storage tanks containing gasoline or diesel fuel.

Which environmental regulations affect farm supply stores directly depends upon whether the stores handle pesticides and/or sell gasoline or diesel fuel. Farm supply stores that handle pesticides will be affected by new pesticide regulations concerning farmworkers and groundwater. For those farm supply stores that also provide petroleum products, the underground storage tank technical standards and financial responsibility requirements will apply. Farm supply stores will also be affected by reporting requirements for toxic chemicals and by restrictions on the land disposal of hazardous wastes.

A farm supply store with fewer than ten employees, that does not handle pesticides and does not sell petroleum fuels, would have no costs associated with the major regulations. A farm supply store that handles pesticides would face increased annual costs of approximately $2,100 and would have first-year costs associated with the farmworkers regulation of approximately $9,000. These annual costs amount to approximately 5% of annual net profits. The first-year costs amount to about 2% of the average store's equity. These figures suggest that farm supply stores that do not sell petroleum should be able to meet environmental requirements without difficulty.

A farm supply store that sells petroleum fuels would have increased annual costs of approximately $4,765, plus capital costs and additional first-year costs of approximately $11,900. These annual costs amount to about 11% of annual net profits. The capital and first-year costs amount to approximately 3% of equity. Again, these figures suggest that farm supply stores should be able to meet environmental requirements without difficulty. Farm supply stores that store petroleum or chemicals in underground storage tanks, may find that their tanks are leaking, however. In this event, they would face corrective action costs. If groundwater contamination or other serious damage must be repaired, these corrective action costs could exceed $100,000, and thus could exceed the equity of the smallest farm supply stores that are in less than average financial condition.

**Interstate Trucking**

Environmental concerns associated with the trucking industry include potential spills and leaks from underground storage tanks (USTs) containing diesel fuel or used oil. If a trucking operation performs its own maintenance, then it uses solvents for degreasing parts. Waste disposal problems would involve used oil and spent cleaning solvents. The used oil might be put into USTs or into drums. The washing of trucks is done with chemicals and steam cleaning, creating wastewater runoff. For a tank truck, the "heel," or what is left in the tank after draining the previous haul, must be steamcleaned out and perhaps handled as a hazardous waste. Small trucking companies usually have these cleaning functions performed by outside services.

The principal environmental regulations that will affect the interstate trucking industry during the period 1988-1992 are those intended to secure the underground storage of fuel and correct any damage caused by leaks. These regulations will apply only to those firms that store petroleum fuels on their premises or store waste oils in USTs. These are generally only the larger trucking companies. The other environmental regulations that will affect the interstate trucking industry will do so indirectly, increasing the price of trucks, fuel, or waste disposal.

Because the most costly regulations will affect only the larger firms, interstate trucking companies should be able to manage the costs of the environmental regulations included in this study. The costs of approximately $3,200 per year for UST and waste-oil regulations represent about 7% of the annual profits of the smallest companies likely to be affected by the regulations. The required investment of $3,000 to upgrade each UST represents about 2% of their net worth.

Trucking companies that find that their USTs have been leaking will face much higher costs, however, possibly exceeding $100,000. EPA's experience to date indicates that 15 percent to 20 percent of the USTs may be leaking. Some of these firms with leaking USTs may be unable to afford the required corrective actions.

**Gasoline Service Stations**

Environmental concerns at gasoline service stations include potential spills and leaks from USTs containing gasoline, diesel fuel, and/or used oil, and vapor emissions from the handling of gasoline. Waste disposal problems at retail gasoline outlets involve used oil and spent cleaning solvents.

The principal environmental regulations that will affect gasoline service stations between 1988 and 1992 are the technical standards for USTs, and the financial responsibility requirements for the owners and operators of USTs. In addition, gasoline service stations in certain areas that are not attaining air quality standards (e.g., St. Louis) will be required to install air emission controls on the nozzles of their gasoline pump hoses. Other EPA regulations that may affect retail gasoline outlets include regulations pertaining to generators of small quantities of hazardous waste.

The major impact of the environmental regulations upon gasoline service stations will depend mostly upon the status of the stations' USTs. The cleanup of even small releases could place the average station in a poor or distressed financial condition. The cleanup of large plume releases could result in the average station's failure. Fortunately, not all firms will incur corrective actions, and some states may use state funds to aid small firms in meeting the costs of corrective action. The capital investments required by the environmental regulations can be sustained by most small firms if they are allowed several years to make the expenditures. If, however, all capital expenditures under all regulations must be met in a two- to three-year period, only the strongest firms are likely to survive.

### Dry Cleaning

Most of the environmental problems in the dry cleaning industry are related to dry cleaning solvents. Over the years there has been a pronounced trend away from the use of petroleum-based solvents and toward the use of perchloroethylene (perc). Over 84% of all dry cleaning facilities use perchloroethylene. Most of the remaining facilities use a petroleum-based solvent, and a small percentage use either fluorocarbon or trichloromethane. Environmental problems are created by the evaporation of these solvents and by the presence of these solvents in wastewaters and solid wastes. Spent solvents and wastes contaminated by solvents are considered hazardous. Dry cleaners that use petroleum-based solvents generally store these solvents in underground storage tanks, with the consequent environmental risks associated with spills and leaks.

The principal environmental regulations that will affect dry cleaners during the 1988-1992 period will be those that control the evaporation of perchloroethylene from perc dry cleaning machines, restrict the handling and disposal of hazardous wastes, and require the reporting of toxic chemicals stored on premises. Dry cleaners that use petroleum solvents will not be subject to the perchloroethylene air emission standards,[*] but may be subject to EPA's requirements for underground storage tanks. Dry cleaners also will be affected indirectly by a series of EPA regulations that will impose stricter standards on waste disposal in general, and hazardous waste disposal in particular.

The most expensive regulations will apply to selected dry cleaners -- namely, perc dry cleaners that have no emission controls (about 50%) and petroleum dry cleaners with regulated underground storage tanks. Unfortunately, the status of these two important regulations is still uncertain.

Businesses in the dry cleaning industry are among the smallest of the small. Most dry cleaners have fewer than five employees, and average sales per employee that are less than half the national average. The median dry cleaner with 1-9 employees in 1983 had profits of less than $10,000 and equity of less than $40,000. While their rate of return on equity was high, the profit available to absorb additional costs is low. Dry cleaners at the lowest quartile of profitability in this size category in 1983 had net profits of only $5,000 and equity of only $8,000.

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[*] Air emission standards for petroleum solvents may be established during the 1988-92 period, but for now EPA has deferred making this decision.

Should perc emission controls be required of the smallest dry cleaners, current estimates show they may have to invest $6,000 or more for the perc controls plus an additional $4,300 for SARA and RCRA and will face additional annual costs of up to $2,800 to meet all of the regulatory requirements. These costs amount to about 35% of the median annual net profits and about 33% of the median equity of dry cleaners with 1-9 employees. Dry cleaners at the lower quartile level of this smallest size category will have to spend about 60% of their annual net profits and over 150% of their equity. These figures suggest that some of the smallest dry cleaners may have difficulty installing perc emission controls in addition to meeting the other environmental requirements. The perc regulation is still under formulation with many options under study, however, so that actual costs for perc emission controls may be much different than preliminary estimates.

Dry cleaners with regulated underground storage tanks will have to invest approximately $7,300 to upgrade their tanks* and meet the additional first-year costs and will face additional annual costs of approximately $3,700. These costs amount to about 40% and 19%, respectively, of the median annual net profits and equity of dry cleaners in the smallest size category. Dry cleaners at the lower quartile level of this size category will have to spend about 80% of their annual net profits and about 100% of their equity. These figures suggest that many of the smallest dry cleaners will have difficulty meeting UST standards. If their underground storage tanks are found to be leaking, these dry cleaners will face much larger costs to complete the required corrective actions. These costs could average over $50,000 and at times could exceed $100,000. Such costs would exceed the equity of the average dry cleaner even in the 10-19 employee size category. Many small dry cleaners will not have thd resources to pay for such large corrective action costs.

### Photofinishing Laboratories

There are five major chemical processing steps that are generally used in processing color film or paper: developing, stopping development, bleaching, fixing, and stabilizing. The developing solutions contain silver, a hazardous but also a valuable material. Some of the other solutions used in photofinishing processes, such as ferrocyanide bleach, are also hazardous. The silver and hazardous solutions are potential sources of environmental problems, if they are allowed to contaminate wastewaters or other wastes.

Because silver is a valuable metal, photofinishers recycle and reclaim the silver so that they generate little or no silver-containing wastes. Small photofinishers also avoid generating hazardous wastes by using nonhazardous bleaching solutions, such as iron EDTA. Finally, photofinishers that process 1,600 square feet of film or less each day are exempt from EPA's effluent limitations for wastewaters. Consequently, most small photofinishers have no substantial environmental problems and will not be affected directly by any of the environmental regulations covered in this study.

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* These costs assume that USTs containing petroleum solvents are regulated as petroleum USTs. If they are regulated, instead, as chemical USTs, dry cleaners' upgrade costs will be greater.

**Water Supply**

The water supply industry consists of both publicly owned and privately owned water supplies. Publicly owned water supplies are predominantly owned by local municipal governments, although a sizable number are owned by the federal government. Privately owned systems that serve large populations are usually investor-owned entities. Privately owned systems that serve smaller populations tend to be owned by real estate developers, homeowners associations, or mobile home parks.

Unlike most industries that EPA regulates, water supply companies do not discharge pollutants or produce hazardous substances. Instead, water supply companies produce a product, drinking water, that is itself considered to be an element of the environment. Consequently, EPA's regulations for water supply companies are similar to product specifications. Instead of establishing standards for the maximum discharge of pollutants, most drinking water regulations establish standards for the maximum level of contaminants permitted in the water that these systems supply to their customers.

Water supply systems are regulated under the 1974 Safe Drinking Water Act (SDWA) and the 1986 Amendments to the Act. Under the 1986 Amendments, EPA is required to promulgate National Primary Drinking Water Regulations (NPDWRs) for 83 specific contaminants. The SDWA requires that regulations for these 83 contaminants, as well as other regulations discussed below, must be adopted on a very stringent schedule -- by June 19, 1989. In addition to the tight EPA regulatory schedule, NPDWRs must officially take effect at the state level within 18 months of promulgation, assuming the state fulfills primacy requirements.

Three other provisions of the SDWA are likely to have significant impacts on the drinking water industry. EPA is required to specify conditions under which public water systems served by surface water sources are required to install filtration as a treatment technique. EPA is also required to promulgate NPDWRs for disinfection as a treatment technique for all public water systems. Further, the SDWA mandates EPA to publish regulations that require public water systems to monitor for a number of "unregulated" contaminants at least once every five years. To help small systems comply with the disinfection requirement and the "unregulated" contaminants monitoring requirement, the SDWA authorizes funds for EPA and the states to provide assistance to small systems. These funds have not been appropriated.

Although the environmental requirements for water supply systems will be expensive, compliance costs ultimately will be reflected in increased rates and borne by customers. Due to often inadequate rate bases, small systems -- particularly those that serve fewer than 2,500 people -- and their customers face the greatest difficulty in financing the necessary compliance activities.

Water supply systems will have to monitor their water for a greater number of contaminants than is currently required and install appropriate treatment equipment if contaminants exist at unsafe levels. Some small systems will most likely have a significant number of violations until adequate treatment is in place; therefore, public notification of violations will be an additional expense.

Recognizing that small systems may be limited in their ability to comply with the new regulations, EPA is attempting to minimize the economic impact on small systems where possible without reducing the protection of public health. The SDWA provides an exemption procedure that allows water supply companies additional time to meet the new standards, provided that the water being delivered in the interim does not present an unreasonable risk to health. It is expected that exemption procedures will be used primarily to assist small supplies in achieving compliance. Water supply systems serving less than 500 service connections, or approximately 1,500 people, are eligible for extendible two-year exemptions. These extendible exemptions may be granted based upon the need for "financial assistance for the necessary improvements," unless there is an unreasonable risk to health.

## CONCLUSION

Although the list of EPA's 85 regulations appears to be foreboding, a closer examination reveals that seventy percent of the 3.5 million small businesses in the United States are in sectors of the economy that produce little or no pollution--wholesale and retail trade, finance, and services. Most of these businesses will not be affected directly by any of the 85 regulations. Small businesses that contribute to environmental problems will incur additional costs to comply with the regulations, however, and in some industries the costs may be high.

This study examined the effects of environmental regulations on small businesses in nine industries judged likely to experience high compliance costs. The study found that costs may be high for small businesses in three of the industries--electroplating, wood preserving, and pesticide formulating and packaging. If costs prove to be as high as estimated and cannot be passed on to consumers, some small businesses in these industries may be forced to discontinue part of their operations or to close. Some small dry cleaners that have underground storage tanks or require substantial perchloroethylene emissions controls may also have difficulty meeting environmental requirements. In addition, certain gas stations, trucking firms, and farm supply stores with leaking underground storage tanks may face corrective action costs beyond their financial means. Small private water supply companies are in a unique position, in that they operate as utilities and generally can pass costs on to their customers. While these firms would not be expected to go out of business, high environmental costs for water supply companies that fail to meet new drinking water standards may necessitate large increases in household usage fees. Environmental costs for one of the industries studied -- photofinishing laboratories--were found to be negligible.

While some small businesses will incur additional costs because of environmental regulations, those small businesses that help to solve environmental problems will experience an increased demand for their services. Small businesses that provide analytical, engineering, or construction services, for example, might be included in this category. The potentially stimulating effects of environmental regulations have not been included in this study.

The regulations that appear to be most often responsible for high costs in the industries studied are those covering the handling and reporting of toxic chemicals; the handling, treatment, and disposal of hazardous wastes; and the operation of underground storage tanks. Although costs estimates are available for only some of these regulations, those that are available indicate that the regulations will affect a large number of firms in many industries and may entail costs in the $5,000 to $10,000 range. Although these costs may be managed easily by small businesses of moderate size, they present difficulties for the smallest of the small businesses. It is these very small businesses that comprise the majority of U.S. businesses.

This relationship between environmental damage and pollution control expenditures is an important element that must be included in this discussion. Environmental regulations are created to reduce the risk to human health, welfare, and the environment from pollution and hazardous substances. Any discussion of the adverse impacts of these regulations must be balanced by a discussion of the benefits that are generated by these same regulations. Cleaning up sites contaminated by hazardous waste disposal or leaking underground storage tanks reduces the exposure of individuals to carcinogens, reclaims and prevents further contamination of drinking water supplies, and restores property values. Controlling the emissions of perchloroethylene from dry cleaning machines reduces both ambient and occupational exposure to a carcinogen. All of the industries studied that will experience significant adverse impacts because of environmental regulations are industries that produce substantial environmental risk. To the extent permitted by law, the regulatory process at EPA includes balancing the costs and impacts of environmental regulations with the benefits produced by reducing these environmental risks.

## Chapter 4

## AGRICULTURE

Environmental regulations affect U.S. farms in many ways. Traditionally, the most important of these regulations have been those that restrict, and in some cases prohibit, the use of certain pesticides. Pesticides will continue to be the subject of the most important environmental regulations for agriculture, not only of the traditional registration and use regulations, but also of new regulations requiring health and safety precautions for farmworkers using pesticides, controls on the use of pesticides in areas with vulnerable groundwater or near targeted estuaries, and restrictions on the use of pesticides that threaten endangered species. In addition, other proposed and forthcoming environmental programs affect agriculture. These include the banning of lead in the gasoline used in farm vehicles, the control of stormwater and other runoff from agricultural lands, restrictions on agricultural burning, standards for the operation and repair of underground storage tanks containing petroleum and chemicals, and the reporting of toxic chemical use.

This study[*] examined the cumulative impact of recent and proposed future EPA actions on the financial condition of farms in the United States. The actions included in the analysis are those that have been promulgated since 1982 or are anticipated to take place by 1992, and have a direct impact on agriculture. The primary goal of the study is not to determine the aggregate total cost of EPA actions on agriculture, but to examine the impact of these actions on the profitability and survivability of U.S. farms. Because of the complexity of the agricultural sector and the many uncertainties that still accompany the new environmental programs, this study has had to limit its focus to a few "representative" farm types and has had to make many assumptions about future environmental requirements and other factors that will affect farms, such as farm support programs under the Food Security Act. Accordingly, the study cannot be considered to cover all potential agricultural impacts or to present the final word on future environmental programs. It does, however, describe the kinds of effects that may occur and estimates the range of potential impacts upon a group of farms that are likely to experience relatively large environmental costs. The study does not address the yield and quality increases associated with environmental quality improvements.

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[*] The Agriculture Sector Study: Impacts of Environmental Regulations on Agriculture; prepared for the U.S. Environmental Protection Agency, Office of Policy, Planning and Evaluation by Terry Dinan of EPA, and Craig Simons and Roger Lloyd of Development Planning and Research Associates, Inc.; September 1988.

## AGRICULTURE AND ENVIRONMENTAL REGULATIONS

There are a number of environmental and health hazards that may be associated with agricultural production. These include:

1. Surface Water Pollution

   Water running off farmlands may carry soil particles, fertilizers, pesticides, and animal wastes into the surface waters.

2. Groundwater Pollution

   Pesticides and sewage sludge applied to fields and crops, as well as petroleum and chemicals from leaking underground storage tanks, may seep into the groundwater.

3. Air Pollution

   Air pollution problems may result from agricultural burning practices and from the use of leaded gasoline-powered trucks, tractors, and combines. In addition, increases in tropospheric ozone can decrease crop yields.

4. Worker Exposure

   Farmworkers who handle pesticides may be exposed to the harmful effects of these chemicals.

5. Endangered Species

   Endangered species may be exposed to the harmful effects of pesticides applied to fields and crops in their habitat. Another threat is a reduction in their habitat caused by agricultural expansion.

6. Dietary Risk

   Pesticide residues may remain on agricultural products that reach the consumer.

Pesticides play a role in most of these hazard pathways and are a critical focus of the environmental regulations that affect agriculture. Every pesticide must be registered with EPA's Office of Pesticide Programs (OPP). OPP reviews the health, safety, and environmental effects of these pesticides and, from time to time, issues regulations that restrict or prohibit the use of certain pesticides that are judged to present an unreasonable adverse effect. As mentioned above, EPA also issues regulations controlling the runoff of waters from agricultural lands, the operation and repair of underground storage tanks, and many other agricultural activities that may present environmental hazards.

These regulations affect both large and small farms in the United States. Restrictions on the use of certain pesticides may require the substitution of more expensive pesticides and/or may reduce crop yields. Other environmental regulations may impose extra operating costs or may require additional investments in land preparation or farm equipment.

The ability of farms to comply with these environmental regulations will depend not only on the costs of each regulation and the effects of the required activities on agricultural yields, but also on the financial condition of each farm, the market conditions at the time the regulations become effective, and the number of farms that are covered. While some environmental regulations apply to all farms, most apply to only a portion of all farms, such as those that use a certain pesticide or have underground storage tanks.

Although the average net farm income in 1984 was identical to that in 1971--$12,000 in constant 1986 dollars -- the financial condition of U.S. farms has fluctuated dramatically over the past two decades. Higher prices, expanding exports, and low real interest rates combined in the early 1970s to produce not only record farm incomes ($25,300 average in 1973), but also a rapid expansion in agricultural production. Unfortunately, these trends all reversed in the early 1980s. Prices declined, exports decreased, and real interest rates rose at an unprecedented rate. Average net farm income fell to a low of $10,200 in 1981 and did not surpass the $12,000 level until 1985. Declining incomes led to declining farmland values and increasing debt-asset ratios. Recently, this trend has begun to change. Decreased production expenses, increased government payments, and lower interest rates have allowed net incomes to rise to an average of $14,000 and have slowed the decline in farmland values. The average debt-asset level in 1987 is expected to show a decline from 1986.

Trends for the average farm may belie significant differences within farm size categories and types. During the 1982-1985 period, farms producing vegetables, melons, and other specialty crops enjoyed average incomes of $60,000 per year. These farms, however, account for only a small portion of all farms. Farms producing cash grain, tobacco, cattle-sheep-and-hogs, general livestock, and animal specialties all had average incomes of less than $10,000 per year. These farms account for 70% of all farms and nearly 50% of farm marketings.

The financial condition of a farm, and hence its ability to comply with environmental regulations, may vary dramatically, even within size categories and types of farms. For example, a study of the financial characteristics of U.S. farms in 1985-1986 showed 55% of all commercial farms were in a favorable financial situation, while 39% were in a marginal situation, and 3% were financially vulnerable.

## STUDY METHODOLOGY AND LIMITATIONS

### Study Methodology

This study consists of an in-depth examination of the cumulative impact of environmental regulations on selected livestock, major field crop, and specialty crop producers. The approach of examining only a limited set of producers was chosen because the primary goal of determining the cumulative impact of EPA actions on the financial condition of producers requires an extensive amount of data collection and analysis. The approach followed in this study is summarized as follows:

1. Select a subset of livestock, major field crop, and specialty crop production to study.
2. Define alternative scenarios of EPA policies.
3. Estimate price changes resulting from EPA actions (under each scenario) for each of the selected crops and livestock.
4. Examine the change in the financial condition of "representative" producers of each of the selected crops and livestock under each scenario.

Crop and Livestock Selection

A crucial step was determining which farms to study. An effort was made to include those farms that were likely to experience relatively large impacts under the alternative EPA policy scenarios considered. The cases examined, therefore, provide a variety of impact levels, but include worst-case examples. For livestock and major field crops, three specific farm types were examined:

* an Illinois corn soybean farm,
* a Mississippi cotton soybean farm, and
* a Kansas cattle wheat farm.

Through discussions with staff at EPA's Office of Pesticide Programs, the following set of specialty crops was selected:

* apples,
* tomatoes,
* potatoes,
* peas,
* caneberries (e.g., raspberries, blackberries, etc.),
* peanuts.

There proved to be insufficient information to complete the analysis for caneberries and peanuts, however, so that results are available only for apples, tomatoes, peas, and potatoes. The difficulty in obtaining information about producers of specialty crops was itself a significant finding of the study.

Definition of Policy Scenarios

Because it is difficult to predict future EPA decisions for many regulations, the study examined three alternative scenarios corresponding to a range of potential policies. The scenarios can be summarized as follows:

| | |
|---|---|
| SCENARIO 1:<br>(conservative) | Past and current EPA actions, plus a conservative (low-cost) set of assumptions about future actions. |

| | |
|---|---|
| SCENARIO 2:<br>(intermediate) | Past and current EPA actions, plus an intermediate (mid-cost) set of assumptions about future actions. |
| SCENARIO 3:<br>(expansive) | Past and current EPA actions, plus an expansive (high-cost) set of assumptions about future actions. |

Actions that EPA has taken in the past five years or plans to take in the very near future were included in all three scenarios. These include the cancellation of toxaphene, dinoseb, and chlorodimeform used for yield enhancement; restrictions on the use of alachlor; farmworker protection standards; regulations under Title III of the Superfund Amendments and Reauthorization Act; and leaking underground storage tank regulations. In addition, the three scenarios include alternative assumptions about EPA actions in the following areas: fungicides, corn rootworm insecticides, broad spectrum organophosphates, grain fumigants, pesticides in groundwater strategy, and lead in gasoline restrictions. In general, the higher-cost scenarios include more pesticide restrictions and cancellations than the lower-cost scenarios. Scenario 3 includes the elimination of lead from gasoline for agricultural use, while scenarios 1 and 2 do not.

Because several of the environmental regulations studied will not affect all of the farms in any category equally, the study examined two variations for each scenario:

* Average Impact Case: This case assumes that the producer experiences the average impact of producers of that type - e.g., if 10 percent of Illinois corn producers would experience a cost of $1,000, the average affected producer would experience a $100 cost ($1,000 x 0.1).

* Maximum Impact Case: This case assumes that the producer must meet all of the requirements of every regulation that may possibly affect producers of that type.

### Estimation of Price Changes

The next step in the analysis was to translate the effects of the regulatory scenarios on crop production costs and yields into commodity price changes. In general, when production costs increase due to the costs of meeting environmental regulations and yields decline due to restrictions on pesticide use, commodity prices will rise. Failure to account for these price increases would result in overestimating the impacts of EPA actions on producers that are directly affected by those actions and would overlook the potential gain to those producers who are not directly affected by the regulations.

To predict the price changes on livestock and major field crop producers, the study used a regional econometric-simulation model, AGSIM. A much more limited price-quantity model was used to predict price changes for specialty crops. The specialty crop model does not account for variations in impacts among different regions or for the impact that EPA actions might have on substitute crops.

### Impacts on Producers' Financial Conditions

Because the information available on producers of major field crops and livestock was more extensive than that available for producers of specialty crops, the study used different methodologies to estimate the impacts of environmental regulations on producers' financial conditions. The study of the impacts on specialty crop producers was necessarily much more limited than that for the major field crop and livestock producers.

To examine the impact of EPA policies on producers of major field crops and livestock, the study used a whole farm financial simulation model of representative producers, REPFARM, developed for each of the selected producers by the U.S. Department of Agriculture. Producers' financial conditions were simulated for the 1987-1996 period under a base case (assuming no EPA actions over the next ten years) and under each of the policy scenarios and impact cases described above. (Note that although EPA actions occurring over the period 1982-1992 were included in this study, the forecast period of 1987-1996 was chosen to illustrate both the effect that past actions have on producers' income and how the effect of actions that are taken change over time.) For each type of producer, the study simulated the impacts on farms in two different financial situations: (1) farms in the average financial condition of all farms of the type/region considered --e.g., the average of all Illinois corn soybean farms, and (2) farms in the average financial condition of all "vulnerable" farms of the type/region considered. Vulnerable farms were defined as farms with a debt to asset ratio of greater than 0.4 and a negative net cash income. The impact of EPA policies on these producers' income and their ability to survive was determined by examining changes in net cash farm income* and debt to asset ratios. It was assumed that a producer would go out of business whenever its debt to asset ratio reached one -- i.e., its level of debt became equal to its assets.

The impact of EPA actions on specialty crop producers was estimated by examining the change in net returns per acre for producers in different production regions. Net returns per acre, as used in this study, are equal to farm income minus all farm expenses on a per acre basis, with the exception of land and non-hired labor. Net returns per acre, therefore, is a measure of the returns to land and farmer-supplied labor. Budget information was collected for each of the selected specialty crop producers in several different production regions to establish a baseline level of net returns. The specialty crop budgets for each region were then projected over the 1987-1996 period, using the average and maximum impacts for each region under each policy scenario, along with the scenario-specific prices (determined by the national price-quantity model).

### Study Limitations

As explained above, the complexity of the agricultural sector, the uncertainty associated with many environmental regulations, and the lack of information on the financial conditions of producers of some crops resulted in the study's being limited to representative farm types and having to rely on many simplifying assumptions. Each of the study's major limitations is discussed in more detail below.

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* Net cash farm income is defined as cash farm income minus cash farm expenses. It does not include depreciation of machinery or off-farm income.

### Examination of a Limited Number of Commodities

Producers of crops not considered in this report will experience levels of impacts that are different from those reported. An effort was made, however, to include in this study farms that are expected to experience relatively large impacts.

### Limited Information About Producers' Financial Conditions

The initial financial condition of a farm is a crucial factor in determining the effect that EPA actions will have on the farm's financial health. For livestock and major field crop producers, the study examined two alternative financial positions. Only limited information was available, however, on the financial conditions of specialty crop producers. This made it difficult to determine whether the EPA actions assumed in the alternative scenarios would actually cause any specialty crop producers to go out of business.

### Uncertainty About Environmental Regulations

As discussed previously, this study does not presume to accurately predict future EPA actions. Rather, it attempts to define a range of impacts that correspond to plausible alternative policy scenarios. In addition, this study does not account for possible indirect impacts on agricultural producers (through regulation of agricultural input industries), nor does it account for actions taken at the state level.

### Uncertainty About the Incidence and Magnitude of Impacts

Predicting which producers will be required to comply with which environmental regulations requires an extensive amount of information. For example, if a particular pesticide is to be canceled, detailed usage data are required to predict which producers will be affected. Pesticide usage data based on statistically valid samples for major field crops are available at state and multi-state production region levels. However, data that are not based on statistically valid samples had to be used for the county-level usage estimates necessary to model the effects of pesticides in groundwater.

Predicting the incidence of EPA actions on specialty crops was especially difficult, because there is less information about pesticide usage on these crops than for major field crops. Much of the specialty crop data used in this analysis were derived from private agencies that do not provide information on the sampling techniques used. This lack of reliable information most be kept in mind when viewing the results for specialty crops.

In addition to knowing what types of producers are likely to be affected by each EPA action, it is important to determine the extent of the impact. For a pesticide cancellation, this requires knowing what alternative will be used in place of the cancelled pesticide and what cost and/or yield variations the user will experience with this alternative. These efficacy data are not always readily available. This increases the uncertainty associated with predicting the yield effects of EPA actions. Furthermore, there was not sufficient information to fully account for changes in quality (e.g., size, shape) brought about by restrictions in pesticides.

Finally, impacts of pesticide cancellations are projected to dissipate evenly over a seven-year period, as users adjust their practices and as new pest control products become available. The use of an arbitrary assumption of this type was necessitated by the lack of a reliable method for predicting the development of substitute pest control products and the adjustment of agricultural practices over time. Clearly, this assumption may overestimate the adjustment process for some cancellations and underestimate it for others. Some commodities, such as apples and oranges, are less able to adjust to pesticide cancellations through the use of more pest resistant species due to the long term structural adjustment problems associated with tree removal and replacement.

### Model Assumptions

In addition to assumptions about the incidence and magnitude of impacts, the models themselves use assumptions that affect the results. For example, the assumptions about how producers respond to changes in production costs and how consumers respond to changes in food prices are crucial in determining the extent to which EPA impacts are passed on to consumers in the form of higher prices. For livestock and major field crops, numerous assumptions about future prices, government policies, interest rates, and cost and yield trends affect the baseline projections of net cash farm income and debt to asset ratios obtained from the REPFARM models. If these assumptions result in an overestimate of the financial strength of the representative farms in the baseline, then we will overestimate the ability of producers to survive in the face of EPA actions. Likewise, if these assumptions result in an underestimate of the financial strength of the farms, then we will underestimate the ability of producers to bear the costs of EPA actions.

## IMPACTS ON LIVESTOCK AND MAJOR FIELD CROPS

This study examined the impact of EPA actions on an Illinois corn soybean farm, a Mississippi cotton soybean farm, and a Kansas wheat cattle farm. The modeling of three regulatory scenarios, two regulatory impact cases, and two financial conditions for each of these representative farms resulted in 18 sets of output for each farm type. This summary presents the results first for farms in average financial condition experiencing average environmental impacts, then for farms experiencing maximum environmental impacts, and finally for farms in a vulnerable financial condition experiencing average environmental impacts. Only the results of Scenarios 1 and 3 (the conservative and expansive regulatory scenarios) are presented, illustrating a range of financial effects predicted based on the full range of policy scenarios considered in this study.

### Farms in Average Financial Condition

Tables 4-1 and 4-2 present the results of the modeling effort for farms in an average financial condition and expected to experience the average environmental costs and yield reductions for their farm type. Table 4-1 presents the estimated changes in net cash farm income (NCFI) and Table 4-2 presents the estimated percentage changes in debt to asset ratios (D/A) for farms.

As can be seen from these tables, the estimated impacts of environmental regulations vary depending on the type of farm, but in general are small for the average impact cases. Under Scenario 1, the average impacted farms experience mean annual decreases in net cash farm income (NCFI) ranging from less than 1% for the Illinois corn soybean farm to 3% for the Mississippi cotton soybean farm and Kansas wheat cattle farm.

A reduction in farm income due to EPA policies may result in increases in farmers' debt to asset ratios in two ways: (1) it decreases the return to land and, therefore, the value of land (which is the primary component of farm assets), and (2) it may cause farmers to borrow funds if they are put into a position of negative cash flow. As shown in Table 4-2, none of the changes in income brought about by EPA actions under the average impact case are large enough to result in significant changes in the representative farms' debt to asset ratios. In all of the average impact cases, the change in the debt to asset ratio is less than 1%.

Under Scenario 3 (the expansive regulatory scenario) for the average impact case, the cash income of the Mississippi cotton soybean farm decreases less than under Scenario 1, and for the Illinois corn soybean farm and the Kansas wheat cattle farm, the net cash farm incomes actually increase. This occurs because the larger cost and yield changes incurred by the affected farms result in reduced production levels overall and lead to higher prices. These higher prices more than offset the average cost and yield impacts experienced by farms. Higher prices come about, however, due to decreases in the production of the commodities of interest.

Although the average impact cases result in minor losses or even increases in NCFI, farms that experience the maximum environmental costs and yield reductions would be adversely affected. In the maximum impact cases, the study assumed that the farms would experience the cost increases and yield decreases associated with each environmental regulation that could possibly affect producers of their type. The maximum impact cases include, for example, costs for the underground storage tank regulations. The potential costs associated with this regulation are substantial, yet only a small percentage of farmers are affected.* The maximum impact cases also include the yield decreases associated with pesticide cancellations, such as dinoseb and toxaphene for Mississippi cotton soybean farms. While few farms will experience the impacts of all regulations, the study examined these cases to put an upper bound on environmental costs and impacts.

Under the maximum impact case of Scenario 1, farms in average financial condition experience mean annual decreases in net cash farm income ranging from 8% for the Illinois corn soybean farm to 18% for the Mississippi cotton soybean farm to 24% for the Kansas wheat cattle farm. Under Scenario 3, these figures are even larger: 26%, 24%, and 84% respectively. The average increases (1987-1996) in debt to asset ratios are also several times larger in the maximum impact cases than in the average impact cases. Under Scenario 3, the increases range from 2% for the Illinois corn soybean farm to 6% for the Mississippi cotton soybean farm to 22% for the

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* Farmers having a petroleum underground storage tank (>1,100 gallons) were assumed to incur a $2,500/yr. insurance cost (1988-1996) and a $500 charge in 1991 and 1994 for a tank tightness test. No costs were included for remedial action, and it was not assumed that any farmers would remove their USTs.

Table 4-1

MAJOR FIELD CROP AND LIVESTOCK FARMS
AVERAGE CHANGE IN NET CASH FARM INCOME (NCFI) (1987-1996)
($1986)

Average Impact Case

| Type of Farm | Average NCFI w/o Regulations | Estimated Change in NCFI<br>Scenario 1 | <br>Scenario 3 |
|---|---|---|---|
| IL Corn Soybean | $ 35,400 | $ -270<br>(-.7%) | $ +4,800<br>(+14%) |
| MS Cotton Soybean | $ 58,900 | $ -1,720<br>(-3%) | $ -1,300<br>(-2%) |
| KS Wheat Cattle | $ 11,600 | $ -380<br>(-3%) | $ +310<br>(+3%) |

Table 4-2

MAJOR FIELD CROP AND LIVESTOCK FARMS
AVERAGE CHANGE IN DEBT/ASSETS (D/A) RATIOS (1987-1996)*

Average Impact Case

| Type of Farm | Average D/A Ratios w/o Regulations | Estimated Change in D/A<br>Scenario 1 | <br>Scenario 3 |
|---|---|---|---|
| IL Corn Soybean | .26 | <.1% | .3% |
| MS Cotton Soybean | .28 | .6% | .5% |
| KS Wheat Cattle | .26 | .3% | .6% |

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* Note that increases in the debt to asset ratio appear as a positive percentage change in this table, but represent a worsening of a farm's financial condition.

Kansas wheat cattle farm. Even in the maximum impact cases, however, none of the farms in average financial condition were predicted to go out of business under any of the regulatory scenarios.

Sensitivity analysis reveals that assumptions about crop yields and future crop prices have a large effect on these results. For example, upper and lower sensitivity runs were made assuming that prices were 15% higher and lower respectively in the years 1991-1996. The resultant NCFIs in the upper sensitivity runs were double those in the lower sensitivity runs. This analysis illustrates the sensitivity of the results of this study to critical assumptions, and helps to place the magnitude of the predicted effects in perspective relative to the other factors that influence farms' financial health.

### Farms in Vulnerable Financial Condition

The initial financial condition of farms is an important factor in determining the impact of EPA actions. Farms in vulnerable financial condition are characterized by high debt to asset ratios and negative net cash income. Further losses caused by EPA actions may force these farms to borrow additional money and, therefore, worsen their debt to asset ratios. In addition, these losses lower the value of their primary asset, their land. The REPFARM model assumes that farms go out of business when the debt to asset ratios reach one.

The percentage of each of the three farm types that are classified as vulnerable is indicated in Table 4-3. The Kansas wheat cattle farm in vulnerable financial condition was predicted to go out of business in 1993 in the base run of the REPFARM model, even without the added burden of environmental regulations. This farm is predicted to go out of business one year earlier due to the income losses caused by environmental regulations under the maximum impact case for Scenario 1. Under all other sets of assumptions, the Kansas wheat cattle farm does not go out of business any earlier due to environmental regulations. The vulnerable Illinois corn soybean farm and the vulnerable Mississippi cotton soybean farm were not predicted go out of business in the REPFARM runs under any of the scenarios with or without environmental regulations.

Table 4-3

FARMS CLASSIFIED AS VULNERABLE

| Farm Type | Total Number of Farms | Percent Vulnerable |
|---|---|---|
| Illinois Corn Soybean | 30,837 | 10% |
| Mississippi Cotton Soybean | 1,798 | 14% |
| Kansas Wheat Cattle | 19,966 | 7% |

Although environmental regulations are not expected to generate larger income losses for farms in vulnerable financial condition than for those who are in better condition, vulnerable farms are more sensitive to income changes and are more likely to feel the results of EPA actions on their financial standing. For example, under the maximum impact case for Scenario 3, both the Illinois corn soybean farm in average financial condition and that in vulnerable financial condition experience a decrease in NCFI of approximately $9,000. The 1987-1996 average debt to asset ratio of the farm in average financial condition increases only 2% due to this loss, however, while the debt to asset ratio of the vulnerable farm increases 24%.

## IMPACTS ON SPECIALTY CROPS

The study included complete analyses of four specialty crops: apples, potatoes, tomatoes, and green peas. Because less information was available for specialty crop farms than for the major crop and livestock farms, the impacts were measured in terms of the net returns per acre, rather than changes in net cash farm income or debt to asset ratios. Net returns per acre measure the returns to both land and farmer-provided labor. Furthermore, the analysis was not able to distinguish between farms in average financial condition and farms in vulnerable financial condition. The analysis was carried out for the same three regulatory scenarios used for the major crop and livestock farms, and for both the average and maximum impact cases. Because the economics of specialty crop farming vary by region, the analysis was carried out for each of the major regions growing the specialty crops studied.

The original study plan included caneberries and peanuts. However, major data problems prevented this part of the analysis. For caneberries, the primary limitation was the lack of information regarding pesticide use and the efficacy of pesticide alternatives. The analysis of peanuts was prevented by unreliable cost and yield estimates associated with various environmental regulations and the lack of critical crop production parameters (e.g., supply elasticities). Lack of accurate usage data, efficacy data, and crop production parameters are problems that are commonly encountered when trying to examine the effects of environmental regulations on specialty crops.

### Average Impact Cases

The results of the analysis for specialty crop farms experiencing average cost and yield impacts are presented in Table 4-4. The changes in net returns per acre under Scenario 1 are less than one percent for most regions and less than six percent for all crops and all regions. The changes in net returns per acre under Scenario 3 are much greater, particularly for apple farms in New York and Michigan. Regional differences in impacts are apparent especially under Scenario 3.

Apple producers in all three study regions (Washington, New York, Michigan) experience similar decreases in net returns per acre under Scenario 1 -- from $2.40 to $3.58 per acre -- but these decreases are higher on a percentage basis in Michigan, because of the state's lower average returns per acre. The large impacts under Scenario 3 and the substantial difference among regions is due to proposed restrictions on the use of fungicides in 1990. These restrictions would substantially affect New York and Michigan apple production (e.g., 17% and 12% yield reductions, respectively, in the average impact case) but have no effect on production Washington.* The slight rise in Washington producers' net returns is due to the increase in price above the base year caused by the national decline in apple supply.

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* The fungicide restrictions considered under Scenario 3 are the cancellation of all EBDCs and chlorothalonil.

## Table 4-4

## SPECIALTY CROP FARMS
## AVERAGE CHANGE IN NET RETURNS PER ACRE (NR/A) (1987-1996
## ($1986)

### Average Impact Case

| Type of Farm/Region | Average NR/A* w/o Regulations | Estimated Change in NR/A Scenario 1 | Scenario 3 |
|---|---|---|---|
| Apples | | | |
| WA | $ 330 | -0.7% | + .2% |
| NY | $ 220 | -2% | -60% |
| MI | $ 80 | -4% | -84% |
| Tomatoes | | | |
| CA | $ 660 | -0.2% | -1% |
| FL | $1,500 | <0.1% | -14% |
| Potatoes | | | |
| WA/ID | $ 600 | <0.1% | +3% |
| MN/ND | $ 240 | -0.8% | -5% |
| ME | $ 130 | -0.8% | -10% |
| Peas | | | |
| WI | $ 200 | -0.6% | <0.1% |
| WA | $ 80 | -4% | -4% |

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[*] Net returns per acre without the added environmental regulations are based on regional budget information and are assumed constant over the period 1987-1996. Net returns per acre reflect returns to land and farmer-provided labor.

These price increases offset any initial yield losses and production cost increases that the Washington apple growers incur under the average impact case. The decreases in net returns for Michigan and New York apple farms under Scenario 3 are dramatic (84% and 60%,respectively) and may bring about substantial structural changes. The discussion of these possibilities is beyond the scope of this study, however.

Decreases in net returns per acre are very small (.2% or less) for both Florida and California tomato producers under Scenario 1. Losses increase substantially for Florida producers under Scenario 3, because of estimated yield losses of 20% due to fungicide restrictions. Because 98% of Florida tomato farms would be affected by these restrictions, as opposed to only 25% of California tomato farms, the losses in the average impact case are greater under this scenario in Florida than in California. The impact estimates for tomatoes under Scenario 3 must be viewed with some caution, however. Yield declines and cost increases were based on information provided by pesticide registrants and have not been thoroughly reviewed by EPA.

The changes in net returns per acre for potato farms under Scenario 1 are less than 1% for all regions. Under Scenario 3, however, the impacts are dominated by the 1990 proposed restrictions on organophosphate use. These restrictions result in 8% reductions in yield on affected acreage, as well as increases in production costs. The magnitude of the impacts in Scenario 3 are projected to result in potato price increases. In Washington-Idaho this increase in price should offset the decline in yield so that net returns actually increase. In the other regions, the net returns per acre are estimated to decrease from 5% to 10%.

The impacts on green pea farms are relatively small under both regulatory scenarios, with the farms in Washington experiencing about a 4% decrease in net returns, as compared with a negligible change in Wisconsin.

**Maximum Impact Cases**

Under the maximum impact case, net returns per acre decrease substantially more than under the average impact case for many crops and regions. There are no dramatic shifts in relative impacts among crops, however, and the conclusions stated above for the average impact case remain generally the same. As with the major field crop and livestock farms, it is important to note that the maximum impact cases represent very unlikely worst cases.

For apple farms, the maximum impact case approximately doubles the decrease in net returns per acre under Scenario 1 for all regions. In Michigan, for example, the decrease is approximately 7%, as compared with 4% in the average impact case. Under Scenario 3, net returns decrease by approximately 74% in New York and over 182% in Michigan (losses of greater than 100% indicate that net returns are negative). As mentioned above, these dramatic reductions in net returns per acre could have a significant effect upon the industry.

The maximum impact case for tomato farms reduces the large differential between impacts in California and Florida under the strictest regulatory assumptions. Under Scenario 1, the estimated decreases in net returns per acre are greater in the maximum impact case than in the average impact case, but remain under 1%. Under Scenario 3, however, the estimated decrease for Florida remains at about the same level as under the average impact case (16% vs. 14%), but the impact for California increases from about 1% to about 20%. As mentioned above, these impact estimates for tomatoes under Scenario 3 were based on information that has not been thoroughly reviewed by EPA, however, and must be regarded as tentative.

For potato farms, the largest percentage change in the maximum impact case under Scenario 1 occurs in Maine, where net returns per acre decrease by nearly 8%, as compared with a decrease of less than 1% in the average impact case. The maximum impact estimates are considerably larger than the average impact estimates because of such regulations as the EDB cancellation in 1984, the dinoseb cancellation in 1987, and the groundwater regulations in 1990. While the combined cost and yield effects of these regulations are significant, only a small percentage of producers are likely to be affected by all of these regulations. Under Scenario 3, the estimated decreases in net returns per acre range from 8% in Washington-Idaho to 20% and 22% in Maine and Minnesota-North Dakota, respectively.

The maximum impact case for green pea farms results in no dramatic changes. Estimated decreases in net returns per acre remain under 1% for Wisconsin farms and increase from about 4% to about 6% for Washington farms under both Scenarios.

## CONCLUSION

This study examined the impacts of recent and proposed environmental regulations on three different types of livestock and major field crop farms in both average and vulnerable financial situations under a variety of regulatory scenarios. For the three types of farms studied, the financial model predicted no closings of the representative farms in average financial condition under any of the regulatory scenarios. The representative Kansas wheat cattle farm in vulnerable financial condition was predicted to go out of business, even in the absence of environmental regulations. The representative Illinois corn soybean farm and Mississippi cotton soybean farm in vulnerable financial condition were not predicted to go out of business, however, even under the most costly regulatory scenarios. Out of the six representative farms examined, none of the regulatory scenarios led to the closing of farms that would not have closed otherwise.

For two of the three types of major field crop and livestock farms studied, the financial condition of the farms that experience the average cost and yield impacts actually improved under the more stringent regulatory scenario. This occurs because the larger cost and yield changes incurred by affected farmers reduce production levels and raise commodity prices. These higher prices more than offset the cost and yield impacts experienced by the average impacted farmer.

Farms that would have to bear the maximum environmental costs and yield changes were found to experience reductions in net cash income many times that experienced by the average farms. Although none of the regulatory scenarios was found to result in the closings of even these maximally affected farms that were in an average financial condition, their average debt to asset ratios were found to deteriorate by up to 23%. Maximally affected farms were those that were assumed to incur all of the cost and yield impacts that were possible for that type of farm. It must be emphasized that the maximum impact scenarios included in this study represent extremely unlikely worst-case events.

Because of limited data availability, the study did not forecast changes in the financial condition of the specialty crop farms. Instead, it examined changes in net returns per acre (which reflect returns to land and farmer provided labor). Under the least costly regulatory scenario, the changes were generally less than 1% for the average farm and less than 8% for even the maximally affected farm. Under the most costly regulatory scenario, however, losses of the average impacted producers increased substantially, particularly for apple producers in New York and Michigan, where predicted losses were 60% and 84%, respectively. These dramatic decreases in net returns may bring about substantial structural changes in the production and markets for the crops affected. Large differences in the impact of EPA regulations on crops grown in different regions occurred because some of the proposed restrictions involve pesticides that are used in some regions and not in others. Even though the results of this study must be considered preliminary, these figures show that EPA actions could create economic problems for some specialty crop farms and suggest that the Agency exercise considerable caution in this area.

Limitations in the necessary data and models must be considered when viewing the results presented in this study. These limitations are most severe for specialty crops, where reliable pesticide usage data often do not exist, and few models are available to predict commodity crop price impacts and farm-level financial effects. Reliable pesticide usage data, efficacy data, national price-quantity models, and farm-level models are important in order to mitigate the potential environmental and health hazards associated with agriculture in a cost effective way. Such needs are likely to become increasingly important in the future, as EPA tries to deal with environmental concerns (such as pesticide damage to endangered species and pesticide contamination of groundwater) that may necessitate very localized restrictions in pesticide use.

## Chapter 5

# POLICY CONSIDERATIONS

The three sector studies summarized in this report have taken a first look at the potential effects of recent and forthcoming environmental regulations on municipalities, small business, and agriculture. Although these studies must be considered as preliminary efforts to shed some light on very complex questions, they have proved useful in describing the kinds of effects that are possible and in suggesting areas of potential policy initiatives and/or of further study.

In response to the findings of these sector studies, several areas for potential policy initiatives have been suggested. While none has been endorsed by the Sector Study Steering Committee, they are presented below to illustrate the kinds of activities that might be considered and to promote further discussion.

## MUNICIPALITIES

Two of the findings of the municipal sector study are that there will be significant increases in household payments for improved environmental services as a percentage of household income in the coming decade, and that many small and some large communities may have difficulty raising the capital needed for investments in new environmental infrastructure. The burden is most severe for small communities because of their lower income levels and higher costs for environmental services. The financial difficulties are partly due to the timing of the needs -- a large new set of investments in a fairly short time period -- and partly due to constraints placed on new revenue potential by existing demands on municipal services.

A number of activities have been implemented by EPA and other initiatives have been suggested to support these small communities' compliance with environmental regulations. These include establishing public dialogues on the issues, and extending technical and financial assistance programs, as well as several others. The study also points to several areas where information from additional research would help identify which activities supported by EPA and states would be most effective in assisting communities as they seek to comply with environmental requirements.

### Public Education Initiatives

Public education has two purposes. First, making people aware of the potential net benefits to be gained by investing in environmental protection should provide a better forum for assessing the merits of the project. Second, where the environmental benefits are diffuse and it is difficult to assign benefits to specific groups of payers (e.g., long-distance air pollution), moral suasion may improve compliance as people become aware of the larger cooperative undertaking that is being proposed. Public notification requirements, and efforts to better communicate information on pollution risks, are but a few of the methods at the disposal of federal, state and local governments to include the public in establishing environmental programs and setting priorities.

### Technical Assistance Initiatives

#### Operations Assistance

In many cases, small communities do not need full-time personnel in all specialties or service areas. Provision (for a fee) of such services by a central authority, either the federal government or state governments, could allow small communities to gain from economies of scale and scope.

Such technical assistance programs could take the form of either guidance-- such as sharing scientific, technical, or management information -- or technical services -- such as supplying laboratory or engineering services. In addition, educational institutions (technical and academic) can continue to play an important role in working with local communities in need of their particular levels of expertise.

#### Public Partnerships

Partnerships provide an informal mechanism for communities to share expertise, to purchase services and goods in larger volumes for discounts, and, more formally, to raise capital in larger more cost-effective blocks. Partnerships between unequal entities could be encouraged by providing incentives to the larger (wealthier) partner. Potential partners include large cities and small cities, well-to-do cities and poor cities, and urban cities and rural cities.

#### Regionalization

Regionalization is a more structured form of partnership, in which two or more communities create a joint venture for a particular purpose, such as construction of a water supply system. This action allows a variety of efficiency gains, including economies of scale and scope, and large-volume purchase discounts. The use of regionalized services may be more suitable for some environmental services, but not necessarily for all services. For example, in those instances where regionalization may lead to a waste disposal service collecting and concentrating pollution risks, the merits of this approach versus de-centralized treatment and disposal operations must be examined.

### Financial Initiatives

#### Reform of Existing Rate Structures

In cases where the basic management structure is in place, rate reform may be necessary to insure the financial viability of the environmental service. Rate reform may include raising the level of rates (increasing revenue) or changing the rate structure (e.g., instituting marginal cost pricing, including peak load pricing when appropriate). Communities can examine current rate structures to insure that rates are generating revenues equal to the full cost of services. Current provisions for obtaining federal grants include this element, and efforts are underway to evaluate whether communities have been establishing suitable rate structures.

### Development Taxes

Special taxes may be levied in areas undergoing rapid growth and development. These assessments could be earmarked for the improvement of environmental services and could be levied on developers directly or on property owners who expect to profit from development. Since environmental improvements often affect property values, a similar approach might be used even in relatively low-growth areas. Many specific versions of development taxes have been devised. A few of the more common are:

- ad valorem on property;
- exactions from developers (in kind or cash); and
- tax incremental financing (tax rates are not changed, but as property values rise, property tax revenues above a baseline are devoted to special uses, such as sewage system construction or road building).

### Special Revenue Districts

Certain geographic areas, within one political jurisdiction or including several jurisdictions, are created for the purpose of raising revenue from residents in the area to be used for specified purposes. Examples include road districts, sewer and water districts, or other types of local service districts.

### Enterprise Fund Management

Utilities or enterprise fund management systems are used to ensure that revenues raised from certain groups of payers are used for the intended purpose and are managed according to sound financial principles. Organizations of these types can help to balance costs and revenues by improving financial management and, therefore, can improve access to capital markets.

### Direct Financial Assistance

Direct financial assistance may be appropriate for low-income communities where it is agreed that the environmental protection services should be made available to all citizens, regardless of ability to pay. It may be appropriate to provide assistance only to those communities that fail an "income" or other "ability to pay" test. Such assistance could be from the state governments, which would need to consider adopting appropriate tests for directing financial assistance, and utilizing them in a consistent manner across the agency. Direct financial assistance could be in the form of either grants for communities that cannot afford the services in the long run or loans for communities that are experiencing a short-term cash-flow problem.

## Other Actions

### Compliance Schedules

If certain environmental regulations do not seem reasonable for a specific group of people, or if the timing of the compliance schedule is not reasonable, then a delay of the regulation or a permanent exemption may be appropriate. Such actions should only be allowed subject to certain constraints, such as that no "unreasonable risk to health" would be created. In all instances, the ability to grant exemptions is dictated by existing legislation. Several existing laws allow for exemptions, but the rules are not consistent, and do not dictate what measures should be considered when allowing for an exemption. The EPA does not have an internally consistent method for determining when the costs of a requirement are unaffordable, either to the household, or for purposes of evaluating impacts on municipal finances. Neither does EPA have criteria for evaluating the cumulative economic impacts of its programs. Efforts are underway within EPA to resolve existing inconsistencies, and establish a protocol for granting exemptions where allowed for by law.

### Privatization

Communities can explore methods of working with private companies to assist in the provision of environmental services. Several aspects of privatization include:

- Private sector ownership, construction and/or operation of facilities (reduce cost of services by taking advantage of economic and/or administrative efficiencies),

- Private financing of new capital formation, or refinancing existing financial obligations (reduce financial obligations of community).

Private companies have been involved in the provision of several environmental activities, particularly solid waste and drinking water services, and a growing number of companies are expressing interests in wastewater treatment services.

Despite the potential advantages of public/private partnerships, the current supply of private firms is relatively small. Private involvement in many environmental services can be affected by federal and state tax requirements, several of which have undergone significant revisions in recent years. Some of the revisions have reduced the tax advantages of public/private ownership. In addition, decisions to use private companies require considerable effort in establishing contractual arrangements and liability responsibilities in cases of damages or permit violations. EPA is currently investigating this issue in greater depth, and plans to hold several conferences with experts in the field and interested parties in the coming months.

## Additional Research

An important finding of the municipal sector study is that not all communities are expected to face financial difficulties. This fact suggests that further analysis should be conducted in order to identify the characteristics of small and large communities that make them more likely to experience difficulty in financing and affording new environmental protection. For example, does a problem typically arise in communities that are:

- very small or sparsely populated (lack economies of scale and scope),
- poorly managed (have poor access to financial markets),
- low income (are unable to afford environmental protection),
- rural (have poor access to technical services), or
- uninformed (lack understanding of the importance of environmental protection),
- facing significant environmental burdens (are currently investing an above average amount of resources to combat existing pollution problems),
- located in a particular state (are some states more aggressive in assisting their financially constrained communities)?

If EPA can better identify those characteristics of communities that most inhibit compliance with environmental regulations, then it can improve upon its current efforts to design and implement programs that are targeted at the sources of the problem.

## SMALL BUSINESS

The small business sector study has provided a number of insights into the potential impacts of EPA's regulations on small businesses. While EPA's primary mission is to reduce the risks posed by environmental damage, the Agency also seeks to minimize the unnecessary adverse social and economic impacts of its regulations whenever appropriate. In this context, the results of this study suggest a number of policy initiatives as well as areas for further study.

### Policy Initiatives

Because many of the new environmental programs cut across many industries and affect thousands of small businesses, new compliance strategies may be needed to supplement EPA's traditional enforcement efforts. Many of the policy initiatives suggested below will help small businesses learn about and comply with the new environmental regulations. This in turn will assist the Agency in achieving higher rates of compliance among small businesses.

These policy initiatives are not necessarily new to EPA. The Agency's Small Business Ombudsman already operates several programs to assist small businesses and the Office of Research and Development (OR&D) is engaged in developing several new technologies for pollution control. The problem areas highlighted by this study provide specific focuses for existing and new programs alike.

### Environmental Technology

It may be possible to reduce environmental costs to small businesses by developing lower-cost control technologies or standardizing existing technologies so that they can be made available at affordable prices.

The results of this study suggest many areas in which new technologies might help solve the special problems of small businesses. Potential projects might include new ways to control stormwater drainage from wood preservers' storage yards, for example, or new processes for dealing with soil that has been contaminated by leaking underground storage tanks.

Even when appropriate technology exists, the required equipment may be available only on a customized basis. By working with the regulated community of small businesses and informing manufacturers of the potential market, EPA might be able to bring down the costs of existing technologies.

### Environmental Services

In some cases, required environmental services are not available to small businesses or are available only at restrictive prices. Many wood preservers, for example, have no disposal facilities available for some of their hazardous wastes. Electroplaters and dry cleaners are also concerned about the availability of disposal alternatives for their hazardous wastes. Similarly, many small businesses that own underground storage tanks are finding that no companies will sell them the required environmental insurance. EPA might work with the regulated community and potential service providers to expand the options available to small businesses.

### Exemplary Programs

For some of the new environmental regulations, thousands of similar small businesses may have to prepare almost identical responses. Their costs might be reduced considerably, if exemplary programs or responses could be made available. Paperwork costs might be reduced, for example, by examples for answers that will be the same for most businesses in a category. Exemplary emergency response programs and employee training programs might be developed as well.

### Education and Training

Sometimes, simply learning how to comply with environmental requirements can be an expensive and time-consuming task for small business owners and operators. Education programs and packages could help to reduce this expense. Such programs could include seminars, response lines, pamphlets and other written materials, and video training programs.

### Joint Programs

Policy initiatives such as those suggested above can be undertaken by EPA on its own or can be carried out with the help of other government agencies. New environmental control technologies, for example, could be developed by and for small businesses through the EPA's Small Business Innovative Research grants, with research targeting problem areas identified in this study. Educational programs could be developed with the U.S. Department of Commerce. State and local governments could be enlisted in the effort as well.

For many programs, it might be desirable to obtain the cooperation of the industries affected. Joint programs could be developed with industry trade associations, for example. Alternatively, EPA development efforts could be supported by small business advisory teams.

## Continued Analysis

This study has pointed to several potential problem areas for small businesses. Additional research might provide more insight into these problems or might show that the problems will not be as large as this preliminary study has suggested. This study also has highlighted the value of detailed small business analysis. EPA can improve the quality of its analyses by maintaining a current data base of financial statistics on small businesses.

### Small Business Analyses

By focusing on industries dominated by small businesses and by paying particular attention to the smallest businesses in these industries, this study has shown how detailed analysis can be especially useful in determining whether environmental regulations will have significant impacts on small businesses. Under the Regulatory Flexibility Act, EPA has a mandate to conduct such analyses for each of its regulations.

The detailed analysis of small businesses was made possible through the use of the Fin/Stat data base provided by the SBA. Because SBA discontinued this data base in 1983, the data used was slightly out of date. Nevertheless, it provided useful information on the financial capabilities of small businesses.

EPA could improve the quality of its small business analyses by obtaining a current data base of financial statistics. Research would be necessary to determine the best source of such a data base and the best format for its maintenance. The SBA could be helpful in preparing the data base, and with other regulatory agencies such as the Occupational Safety and Health Administration, might be interested in sharing the data base with EPA.

### Multi-Regulation Impact Analyses

This study has identified several industries for which the combined effects of several environmental regulations will result in considerably more impact than the effects of any one regulation taken alone. Continued analysis of the combined effects of all of EPA's regulations on those industries identified as being subject to many regulations will help the Agency maintain a broader perspective of regulatory impacts and will put the impacts of new regulations in a more accurate perspective.

### Regulatory Analyses

This study has pointed to a number of potential problem areas associated with individual regulations. Continued analysis of these regulations will not only provide better information on the actual economic impacts of this regulations, but will also provide insights into how the regulations might be improved.

A good example of a regulations that might bear further analysis are those promulgated under Title III of SARA. The cost for an "average small business" to comply with emissions reporting requirements under Section 313 of Title III has been estimated to be approximately $9,000 per year, a cost that appears to be prohibitive for many of the small businesses included in this study. Cost estimates for Section 313 have been prepared, however, using assumptions of an average number of toxic chemicals reported and an average level of analysis. Furthermore, the estimates do not consider that many small businesses will be able to take advantage of the range-reporting option that EPA has developed to reduce their reporting costs. Thus, many small businesses included in this study may be able to comply with Section 313 at a cost that is considerably lower than that estimated. Continued analysis of how small businesses actually comply with these regulations will enable EPA to better assess not only the impacts but also the efficacy of the regulations.

## AGRICULTURE

The agriculture sector study illustrates the advantages of examining the impacts of environmental regulations at the farm level as well as at the aggregate national level. While national analyses provide useful information concerning the total losses incurred by different aggregate types of farmers (e.g., corn farmers as a whole), the impact of environmental regulations on farms' financial conditions depends on the distribution of those losses among farmers and on the initial financial conditions of the affected farms. In order to determine the affect of EPA regulations on the ability of farms to survive, both aggregate and farm level analyses are necessary.

This study highlights the data and analytical requirements necessary to determine the impacts of EPA actions on agriculture. Such requirements include:

1. Accurate pesticide usage data,
2. Accurate pesticide efficacy data,
3. Improved information on how initial pesticide cancelation affects change over time,
4. Accurate incidence data for non-pesticide related impacts (e.g., underground storage tanks),
5. Improved national price-quantity models to predict commodity price changes due to EPA actions, and
6. Better information on the initial financial and production conditions of agricultural producers and farm level models for estimating changes in these over time.

The need for better data and modeling capability is greatest for specialty crops, where reliable pesticide usage and efficacy data often do not exist, limited information is available on producers' initial financial condition, and few models are available. EPA currently is compiling a directory of all specialty crop models available for use in economic analyses and is funding the development of additional specialty crop models. Improvements in pesticide usage data might be obtained by increased cooperation and cost sharing with USDA and states to fund additional pesticide usage surveys or t add pesticide usage questions to surveys designed for other purposes. In addition, registrants of pesticides might be required to provide usage information. The importance of using farm level models and improving data and modeling capabilities is likely to increase in the future as EPA tries to cost-effectively reduce environmental risks associated with agriculture.

## Appendix

# ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

## Appendix

## ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | Air | | |
| 1. | Rural Fugitive Dust | CAA Section 110, 165, 169 / Agricultural Burning | undetermined |
| 2. | Stratospheric Ozone | Stratospheric Ozone Protection Strategy | 8/88 |
| 3. | Municipal Waste Combustors | NSPS: Municipal Waste Combustors (Assessment of Municipal Waste Combustor Emissions Under the Clean Air Act) | 12/90 |
| 4. | TSDF Air Standards | Treatment, Storage, and Disposal Facility Area Source Air Emissions - RCRA Standards | 9/90 |
| 5. | Diesel Fuel Standards | Diesel Fuel Modification | 7/89 |
| 6. | Diesel Particulate Standards | Nonconformance Penalties for 1991 through 1994 Model Year Emission Standards for Heavy-Duty Vehicles and Engines | 3/89 |
| 7. | Fuel Volatility | Control of Excess Evaporative Emissions/ Fuel Volatility | 1/89 |
| 8. | Gas Marketing | Decision on Air Pollution Regulatory Strategies for the Gasoline Marketing Industry | 1/89 |
| 9. | Lead Phasedown | Removal of Lead from EPA Certification and Test Fuels (Revision) | 1/88 |
| 10. | NAAQS: Lead | NAAQS: Lead | 3/90 |
| 11. | NAAQS: Particulate Matter | NAAQS for Particulate Matter (Revision) | undetermined |
| 12. | NESHAP: Chromium | NESHAP: Chromium--Electroplating | 3/91 |
| 13. | NESHAP: Perc Dry Cleaning | NESHAP: Perchloroethylene Dry Cleaning | undetermined |
| 14. | NSPS: Small Boilers | NSPS: Small Boilers | 9/90 |
| 15. | NSPS: Industrial Boilers | NSPS: Industrial Boilers | 12/87 |
| 16. | NSPS: Woodstove | NSPS: Residential Wood Combustion | 2/88 |

Appendix (cont.)

## ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | **Radiation** | | |
| 17. | Radon | | undetermined |
| 18. | Radiofrequency Guidance | Federal Radiation Protection Guidance: Proposed Alternatives for Controlling Public Exposure to Radiofrequency Radiation | 7/89 |
| 19. | Low Level Radioactive Waste | Environmental Protection Standards for Low-Level Radioactive Waste | 5/89 |
| 20. | High Level Radioactive Wastes | Environmental Standards for the Management and Disposal of Spent Nuclear Fuel, High-Level and Transuranic Radioactive Wastes | undetermined |
| | **Pesticides** | | |
| 21. | Inerts | | undetermined |
| 22. | Farmworkers | Worker Protection Standards for Agricultural Pesticides (Revision) | 3/89 |
| 23. | Pesticides in Groundwater | | 2/89 |
| 24. | Large Volume Pesticides | | undetermined |
| 25. | Data Requirements | Comprehensive Revision of Pesticide Registration and Classification Procedures (Revision) | 5/88 |
| 26. | Reregistration of Pesticides | | undetermined |

### Appendix (cont.)

### ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | **Toxic Substances** | | |
| 27. | Asbestos Ban and Phasedown | Action Concerning Commercial and Industrial Use of Asbestos | 1/89 |
| 28. | Asbestos in Schools | Asbestos Reinspection Rule | 10/87 |
| 29. | Chlorinated Solvents | Regulatory Investigation of Chlorinated Solvents | 6/89 |
| 30. | PCBs: Electrical Equipment | Polychlorinated Biphenyls/Manufacturing, Processing, Distribution in Commerce and Use Prohibitions: Use in Electrical Equipment | 9/88 |
| 31. | PCBs: Electrical Transformers | Polychlorinated Biphenyls in Electrical Transformers: Final Rule | 7/88 |
| 32. | Premanufacture Review Program | | undetermined |
| | SARA | | |
| 33. | Title III of SARA | Emergency and Hazardous Chemical Inventory Forms and Community Right-To-Know Reporting Requirements, and | 9/89 |
| | | SARA Section 313 Toxic Chemical Release Reporting Rule | 6/89 |
| | RCRA | | |
| 34. | Subtitle C Location Standards | Location Standards for Hazardous Waste Facilities | 12/88 |
| 35. | Subtitle D Criteria | Solid Waste Disposal Facility Criteria | 12/88 |
| 36. | Liner and Leachate Collection | Double Liner and Leachate Collection Systems for Hazardous Waste Land Disposal Units | 9/88 |
| 37. | Corrective Action at SWMUs | Corrective Action for Solid Waste Management Units (SWMUs) at Hazardous Waste Management Facilities | 11/88 |
| 38. | Hazardous Waste Burning | Burning of Hazardous Waste in Boilers and Industrial Furnaces | 10/88 |

**Appendix** (cont.)

## ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | RCRA (cont.) | | |
| 39. | Municipal Ash | Municipal Waste Combustor Ash Management | 12/89 |
| 40. | Land Ban - First Thirds | Land Disposal Restrictions for First Third of Scheduled Wastes | 8/88 |
| 41. | Land Ban - Soil and Debris | Land Disposal Restrictions for Soil and Debris Containing Hazardous Wastes | 10/91 |
| 42. | Land Ban - Dioxin | Restrictions on Land Disposal of Specified Solvent Dioxin Wastes | undetermined |
| 43. | Land Ban - Cal. List | Land Disposal Restrictions for Certain Hazardous Wastes - California List | 7/87 |
| 44. | UST Financial Responsibility | Underground Storage Tanks Containing Petroleum - Financial Responsibility Requirements | 5/88 |
| 45. | UST Technical Standards | Underground Storage Tanks - Technical Requirements / Technical Standards and Corrective Action Requirements for Design & Operation of USTs Containing Petroleum and Hazardous Substances | 5/88 |
| 46. | Hazardous Waste Tank Standards | Hazardous Waste Tank Standards | undetermined |
| 47. | Toxicity Characteristics | Identification of Hazardous Wastes by Toxicity Characteristics and Listing of Additional Organic Toxicants | 8/88 |
| 48. | Small Quantity Generator | RCRA Small Quantity Generator Rule | 3/86 |
| 49. | Waste Oil Management | Management of Used Oil | undetermined |
| | CERCLA | | |
| 50. | National Contingency Plan | National Oil and Hazardous Substances Pollution Contingency Plan (NCP) | 11/89 |
| 51. | CERCLA Settlement Policy | | undetermined |

**Appendix** (cont.)

### ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | **Drinking Water** | | |
| 52. | Total Coliform Rule | National Primary Drinking Water Regulations (NPDWR): Microbials and Filtration of Surface Drinking Water Supplies | undetermined |
| 53. | Surface Water Treatment - Filtration | | undetermined |
| 54. | VOCs in Drinking Water | NPDWR: MCLs for Volatile Organic Chemicals Found in Drinking Water | 6/87 |
| 55. | SOCs in Drinking Water | | undetermined |
| 56. | Inorganics in Drinking Water | NPDWR: Inorganic and Organic Compounds | undetermined |
| 57. | Fluoride in Drinking Water | | undetermined |
| 58. | Lead MCL and Corrosion Control | | undetermined |
| 59. | Lead Ban | Public Water System Supervision Program: Ban on Lead in Plumbing | 6/86 |
| 60. | 34 MCLs | | undetermined |
| 61. | Radionuclides | NPDWR: Radionuclides | undetermined |
| 62. | Disinfection | NPDWR: Disinfection, Disinfectants and Disinfection By-Products (Revision) | undetermined |
| 63. | Public Notification Rule | | 10/87 |

Appendix (cont.)

## ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

|  | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
|  | Groundwater |  |  |
| 64. | Well-head Protection |  | 12/87 |
| 65. | Class I Underground Injection Wells | Underground Injection Control Program / Hazardous Waste Disposal Injection Restriction for Class I Hazardous Waste Injection Wells | undetermined |
| 66. | Class II Underground Injection Wells |  | undetermined |
| 67. | Class V Underground Injection Wells |  | undetermined |
|  | Surface Water |  |  |
| 68. | Construction Grants Program | Comprehensive Construction Grant Regulation Revision | 5/89 |
| 69. | Secondary Treatment Waivers | CWA Section 301(h) Revisions | undetermined |
| 70. | Municipal Sewage Sludge | Sewage Sludge Use and Disposal Regulations | 12/89 |
| 71. | State Sludge Management | National Pollutant Discharge Elimination System Sewage Sludge Permit Regulations; State Sludge Management Program Requirements | 2/89 |
| 72. | Pretreatment | Final Revisions to General Pretreatment Regulations for Existing and New Sources | undetermined |
| 73. | Stormwater | NPDES Regulations: Stormwater Application Requirements (Revision) | 11/89 |
| 74. | Nonpoint Sources | Section 319 of the Clean Water Act / Nonpoint Source Guidance | undetermined |
| 75. | Wetlands | 404(c) Regulations / Actions | undetermined |
| 76. | National Estuary Program |  | undetermined |

### Appendix (cont.)

### ENVIRONMENTAL REGULATIONS INCLUDED IN THE SECTOR STUDIES

| | Program/Short Title | Legislative Title | Promulgation |
|---|---|---|---|
| | Surface Water (cont.) | | |
| 77. | Toxic Water Pollutants | Section 304(l) of the Clean Water Act Regulations | |
| 78. | Ocean Dumping | Comprehensive Revisions to Ocean Dumping Regulations | 8/89 |
| 79. | ELG: Foundries | Metal Molding and Casting Industry Point Source Category Effluent Limitations Guidelines, Pretreatment Standards and Nonpoint Source Performance Standards | 10/85 |
| 80. | ELG: Placer Gold Mining | Effluent Limitations Guidelines for the Placer Gold Mining Industry | undetermined |
| 81. | ELG: Machinery Manufacturing and Rebuilding | Effluent Limitations Guidelines for the Equipment Manufacturing and Rebuilding Industry | undetermined |
| 82. | ELG: Oil and Gas | Effluent Guidelines for Offshore Oil and Gas Extraction Industry (Revision) | 3/90 |
| 83. | ELG: Organic Chemicals | Effluent Guidelines for Organic Chemicals and Plastics and Synthetic Fibers | 12/87 |
| 84. | ELG: Pesticides | Effluent Guidelines for Pesticides Chemicals | 9/91 |
| 85. | ELG: Pulp and Paper | Effluent Guidelines for Pulp, Paper and Paperboard | 5/88 |

# Presidential Oversight:

## CONTROLLING THE REGULATORS

**W. Kip Viscusi**

**Abstract** *In 1974, President Ford initiated a procedure by which the regulatory policies of federal agencies were subjected to systematic oversight. This activity continued with modest success through subsequent administrations. A substantial stiffening of oversight powers under President Reagan raises basic questions about the best means for performing effective oversight. Proposals for a so-called regulatory budget, within which each agency would be obliged to operate, could expand the oversight authority; but it is too exclusively cost-oriented. A more promising approach is to impose expiration dates on regulations, making them subject to renewal, and to reform the legislative mandates of the regulatory agencies.*

In the operation of an establishment as extensive and complex as the executive branch of the U.S. government, one of the most daunting problems confronting the president is to maintain some degree of control over the activities of the multifarious departments, agencies, and commissions that are nominally accountable to him. Programs that entail large expenditures of money generally are subject to a considerable amount of control both before and after the expenditures take place. But programs that are regulatory in character have traditionally been much more freewheeling. With the increasing recognition of the importance of such programs to the functioning of the U.S. economy, recent presidents have been attempting to devise more effective sytems of oversight. But the system of oversight is still incomplete and ineffective in many fundamental aspects.

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## EVOLUTION OF THE OVERSIGHT PROCESS

When agencies are responsible for heavy expenditures of funds, they cannot escape careful scrutiny.[1] Such scrutiny begins with the initial approval of their programs by the Office of Management and Budget (OMB) and the Congress, and continues through annual budgetary reviews by these two groups. The policies of the regulatory agencies, on the other hand, were relatively free from any systematic review within the executive branch until the mid-1970s.

In some cases, this autonomy derived from the independent administrative structure Congress established for many regulatory agencies.[2] To endure fair regulatory decisions that would be less subject to transitory political factors than the activities of the executive departments, Congress placed much regulatory activity within independent, quasijudicial administrative structures; the role of the president in such cases was usually to appoint commission chairmen and fill vacancies on commissions, but not to exercise control over the substantive decisions and policies of the commission.

The principal functions of the earliest regulatory commissions were to govern the entry of firms in some branch of business or to control the pricing of their services. For example, the Interstate Commerce Commission sets policies affecting the rate structure and degree of competition in the railroad and trucking industries, and the Federal Communications Commission establishes regulations governing the allocation and use of radio and television broadcasting rights. More recently, independent commission status has been accorded to two agencies with much different kinds of concerns. The Nuclear Regulatory Commission and the Consumer Product Safety Commission, both of which focus on health and safety risks, were established in the 1970s.

Even regulatory agencies that did not have special status as an independent agency, such as the Environmental Protection Agency and the Occupational Safety and Health Administration (OSHA), have led a relatively autonomous existence. While the administrative budgets of such agencies were subject to the usual budgetary processes, their regulations were not subject to annual review within the Executive Office of the President. In the occasional instances in which regulations aroused some controversy, the regulatory agency exercised considerable leverage because of its superior access to information about the regulation. When regulations were questioned, agencies that were engaged in health, safety, and environmental regulation also could justify their actions by referring to their legislative mandates. As a rule, such agencies interpreted these mandates as requiring them to promote clean air, noncarcinogenic food, and job safety without taking account of their associated economic costs.[3]

Although the so-called independent agencies had an explicit mandate that supported their independence, it may be that they were actually less free of the influence of the presidential office than the agencies that lay within the departmental structure. The statutes that gave powers to independent agencies, such as those engaged in rate and entry regulation, usually carried fewer restrictions, guidelines, and standards that would affect the choice of policies; hence, the president could alter the policies of these agencies substantially by a judicious selection of the key appointed officials. The deregulation of airlines and trucking under the Carter administration occurred largely through such shifts in personnel. In contrast, the principal agencies addressing health, safety, and environmental risks—none of which has the status of an independent agency—for many years have used their legislative mandates to insulate their policies from White House influence.

The lack of presidential oversight over regulatory activities would not be an issue if the policies of such agencies never aroused widespread protest. During the 1970s, however, there was growing dissatisfaction with the efficacy of both the traditional ratemaking regulations and the newer social regulations. To introduce some presidential control over regulatory policies, President Ford issued an executive order in 1974 requiring that all major regulatory initiatives be accompanied by a statement that analyzed the effect of the initiative on inflation.[4] Any proposal whose national impact on costs would exceed a stated threshold had to include an analysis of its effect on supplies, competition, and productivity, and had to estimate the costs imposed on consumers and business. Shortly thereafter, agencies were required to review the policy alternatives.[5] This comparison of benefits and costs, however, was not tantamount to a formal economic benefit–cost test; agencies could still pursue policies in which measurable economic costs appeared to exceed economic benefits.

To administer this oversight process, a new agency, the Council on Wage and Price Stability (CWPS), was established by law within the Executive Office of the President to oversee the inflationary aspects of the regulations. The authority of the new agency was quite broad, covering not only the agencies subject to the president's direct control but also the independent agencies such as the Interstate Commerce Commission. For all such agencies, the council was authorized to

> intervene and otherwise participate on its own behalf in rulemaking, ratemaking, licensing and other proceedings before any of the departments and agencies of the United States, in order to present its views as to the inflationary impact that might result from the possible outcomes of such proceedings.

As a consequence, CWPS had the authority not only to discuss proposed regulations with the regulatory agencies but also to make its comments part of the public record in the rulemaking proceeding. These assessments, which were usually filed during the period in which public comment was invited, typically took the form of critical evaluations of the agency's impact statements. CWPS made about 50 public filings annually in the public record, a rate of activity that changed very little over the years of its existence. Table A1 in the Appendix provides a summary of this activity.

In the first year of the Carter administration, the oversight process continued as before. In 1978, it was strengthened with an executive order requiring agencies to show that "alternative approaches have been considered and the least burdensome of the acceptable alternatives have been chosen."[6] At the same time, the Council on Wage and Price Stability was joined by an informal working group known as the Regulatory Analysis Review Group, which included representatives of the Council of Economic Advisors, the Office of Management and Budget, and various executive agencies. CWPS, in conjunction with the Council of Economic Advisors, provided the primary staff support for this effort.

President Carter established the Regulatory Analysis Review Group to increase the political leverage that could be exerted by CWPS analyses. The Regulatory Analysis Review group was formed as a vehicle for establishing a consensus in the executive branch on the most important regulatory proposals each year, so that the impact of the White House oversight effort could be enhanced. However, although the CWPS public statements helped foster debate on regulatory issues, CWPS lacked any formal powers for influencing such policy. To be sure, White House officials could draw on the CWPS analyses in attempting to influence regulatory actions; and, as I shall point out later, these analyses were not without substantial influence in many cases. But their influence was distinctly limited.

Despite the increasing complexity and formality of the oversight mechanism, the monitoring of the Carter administration followed very much the lines developed earlier in the Ford administration. During the Ford and Carter administrations, the staff responsible for the regulatory analyses remained largely unchanged, as did the substance of the analyses. Although the number of proposals considered did not increase, the direct and indirect costs to the economy associated with the proposals rose dramatically. For one class of regulation introduced for consideration in 1978—the class pertaining to health and safety risks—the estimated costs to the economy reached as high as $200 to $600 billion. (For a survey of costs associated with each year's proposals see Table A2 in the Appendix.)

## OVERSIGHT UNDER PRESIDENT REAGAN

With the election of President Reagan, the emphasis shifted to inhibiting the introduction of new regulations rather than simply promoting sounder regulatory policies. Shortly after taking office, President Reagan abolished the Council on Wage and Price Stability and shifted its regulatory review staff to the Office of Management and Budget (OMB).[7] This relocation of the CWPS operation was not without its costs. By abolishing CWPS, President Reagan sacrificed the legal authority of the presidential office to make public filings on regulatory issues. The White House could no longer offer comments on the efforts of independent regulatory commissions, and its reviews of regulations issued by agencies within the executive branch no longer appeared in the form of regular public statements.

Nevertheless, with the shift of the CWPS staff to OMB, the oversight process was strengthened. President Reagan coupled this reorganization with the establishment of more rigid standards for the regulatory policies of executive branch agencies. Reagan established a benefit–cost test for proposed regulations, created an OMB clearance process in which approval must be given before an agency may formally propose a new regulation, and instituted a formal mechanism for determining whether existing regulations should be withdrawn. In effect, Reagan made regulatory oversight a dominant part of the formation of regulatory policies rather than a minor adjunct to this process. To limit the number of conflicts brought to the president, Vice President Bush was given broad authority over regulatory issues.

From all appearances, two main criteria are now being used by the OMB oversight group to gauge the effects of a proposed regulation. One is essentially an analysis of aggregate social benefits and social costs; this is a task assigned primarily to the former CWPS staff, composed of 20 persons, including support staff. The other is an analysis of the costs imposed on the regulated industries, in the form of paperwork and other costs. This aspect of the analysis is undertaken by a considerably larger OMB staff. Although the administration's formal announcements stress the benefit–cost approach, the relative size of the staffs assigned to the two activities suggests that the question of industry burden is receiving the lion's share of the administration's attention. If that is the case, it is a major shift from the emphasis of the oversight group in earlier administrations, when the benefit–cost assessment dominated.

The fact that the OMB can review the proposals of the regulatory agencies but cannot submit comments for the public record alters the oversight process in another important respect. OMB's criteria for action are not available for public scrutiny, and negotiations between the White House and the agencies have gone underground. Careful analyses may or may not be prepared for internal use in the OMB. Operationally, OMB is in a position, if it wishes, to reject all major proposals without such a record. If supporting analyses are prepared, these internal documents will not serve to stimulate public debate or to provide support for judicial actions against the regulatory agency.

The only recourse for a regulatory agency is to appeal OMB's decision to Vice President Bush's Task Force on Regulatory Relief. Since the staff director of the task force is also the head of the OMB oversight unit, there is a strong presumption that the OMB position will be upheld. Nevertheless, in the only OMB decision appealed to the vice president, a regulation proposed by the Occupational Safety and Health Administration, OSHA's position prevailed.

Even if agencies manage to make successful appeals to the vice president, the oversight policy process will represent a dramatic departure from pre-Reagan policies. The fact that an agency has to make such an appeal in order to issue a regulation that OMB opposes is in itself a major transformation. Previously the burden was on CWPS and other White House groups to attempt to block a regulatory initiative, usually by appealing the proposal to the president. Since only a limited number of policy debates can be elevated to this level, regulatory agencies continued to operate almost without restriction. Now, however, the burden of appeal falls on the regulatory agency seeking to issue a regulation, effectively shifting the power over new regulations to the oversight unit.

There are other features of the Reagan approach that reinforce the oversight power. Particularly useful is OMB's authority to review regulations before they are proposed. By increasing the degree of oversight authority and shifting the review process to an early stage before the positions of the various actors become well established, the new oversight process should be better able to influence the final policy outcome.[8] By reviewing regulations before they are formally proposed, OMB can limit the role of external political actors. In one of the rare cases in which CWPS and the Council of Economic Advisors appealed a regulatory policy to President Carter, a policy involving the imposition of stringent standards for the control of cotton dust in textile mills, the president upheld the standard; in this case, the fact that organized labor was solidly behind the regulation was instrumental in the decision. Regulatory agencies can still seek to establish such political support by publicly committing themselves to some stated line of policy. As in the past, the commitment could be used to gain leverage over the OMB oversight group. But the firmness of the support will not be as great, inasmuch as the details of the regulation will not be publicly known until after they are formally proposed.

The Reagan reforms also appear to have strengthened the substantive aspects of the oversight process by mandating a benefit–cost test except when prohibited by an agency's legislation. How extensively such tests will actually be imposed will depend in part on the courts' interpretation of existing legislation. The Supreme Court, for instance, has explicitly prohibited the use of a benefit–cost test for OSHA standards pertaining to toxic substances and hazardous physical agents. Since the statutory mandates in most risk-reducing legislation are written narrowly, court decisions of that kind could prove quite common. To be sure, OMB can nevertheless address benefit–cost issues in its regulatory review process; but the courts could entertain suits that would enjoin the administration from blocking regulations on benefit–cost grounds, should the reasons for the OMB decision become public.

As with the oversight mechanisms of earlier administrations, OMB's authority pertains almost entirely to new regulations. There is no retrospective assessment of the efficacy of regulations once they are in effect, nor is there a review of the accuracy of the original analyses that justified them. Most of the analyses of the impact of existing risk regulations, to the extent that they have occurred, have been performed by independent academic analysts.

Within the presidential oversight operations there has been no systematic effort to undertake policy evaluations of this type.[9] On the cost side, a number of developments could easily render the original estimates obsolete. For example, do new regulations lead to innovative responses that reduce cost levels below the levels anticipated? Or conversely, do cost reductions that had been anticipated fail to be realized? On the benefit side, the need for retrospective analysis is even greater, particularly because of our increasing knowledge about many types of environmental risks that are the focus of regulatory policies.

In sum, the Reagan oversight procedures have increased the institutional authority of the review group over new regulatory proposals, but have severely limited the public's access to the discussions underlying regulatory decisions. The net effect of this change should be to enhance the power of those charged with the regulatory review process. But the criteria being applied to new regulations will be less transparent and the possibilities of informed public participation more limited.

## THE IMPACT OF THE OVERSIGHT PROCESS

Because the Ford and Carter administrations left behind a rich paper record of their review procedures, it is possible to make some estimates of their effectiveness. When these activities went underground in the Reagan administration, such evaluations became more difficult; but even in the case of that administration, some preliminary judgments are possible.

Recall that during the Ford and Carter administrations the White House oversight group had no right of veto over regulations proposed by one of the regulatory agencies. The reviewing body—the Council on Wage and Price Stability—was only authorized to analyze and comment on the proposals of the regulatory agencies. The collaboration of the Regulatory Analysis Review Group in the CWPS analysis was intended to increase the degree to which these regulatory critiques were regarded as a White House consensus; but even with this endorsement, agencies did not face strong pressure to comply with all of the suggestions.

For major regulations, agencies were simply required to prepare cost and benefit estimates for alternative policies, which the White House oversight group analyzed and discussed on the public record. This analysis in turn became the substantive basis for lobbying efforts by White House officials. To evaluate the effectiveness of that process properly, ideally one would like to compare the regulations actually issued with those that would have been promulgated in the absence of the review procedures. Reliable information of this type is not available even on an anecdotal basis, since few agency officials are willing to discuss the extent to which they have been affected by the oversight activities.

Nevertheless, clues regarding the effects of the process in the Ford and Carter administrations are not wholly lacking. Over the years, agencies began to calculate the costs of a proposed regulation; and in many instances, benefits also were calculated, albeit on a more rudimentary basis. Where risk and environmental regulations were involved, for example, benefits typically were in physical units (such as lives saved or visibility increased at national parks) rather than in monetary terms. These estimates were generally believed to be reasonably unbiased; and in instances in which a clear conceptual error was made, the supporting data were often sufficient to provide CWPS with a basis for adjusting quantitatively for the error.

While increased information about the economic implications of regulations does not ensure efficient regulation, it does provide a basis for more effective debates concerning the appropriate regulatory policy. By reducing the regulatory agency's almost exclusive control over the data pertaining to a regulation's effect and by promoting the generation of data pertinent to responsible policy evaluation, the regulatory review process served to strengthen efforts within and outside regulatory agencies to make regulations more efficient.

In some instances, the review process itself fostered this discussion. During the Ford and Carter administrations, analysts from the White House staff and their regulatory agency counterparts were in frequent contact. In cases in which a regulatory analysis was elevated to the Regulatory Agency Review Group, there were usually a number of meetings between this group and the affected agency to debate the merits of the regulation. As a result, economic analysts acquired a larger policy role within regulatory agencies; the economic consequences of regulations became a central part of most policy debates, an emphasis that differed considerably from the discussions that had existed in the period before the review process was instituted. These debates, in turn, focused on extensive and often insightful analyses that had emerged as a result of the review process. In almost all instances in which CWPS intervened in collaboration with the Regulatory Analysis Review Group, the final regulation was closer to the White House position than was the initial proposal.

The progress that was observed in the revision of regulations may understate the full impact of the regulatory analyses. Even when the recommendations of the White House were not adopted, they did provide a substantive basis for supporting future regulatory reforms. In 1980, for example, when the Carter administration undertook an economic aid program for the auto and steel industries, its agenda of regulatory changes for those industries was based largely on findings that had previously been developed in the regulatory review process. And when the Reagan administration launched its inaugural flurry of actions rescinding various regulations that had already been placed on the books, those actions too were based almost entirely on past analyses by the reviewing staff of the Carter and Ford administrations. Moreover, in all of these cases, the White House regulatory oversight staff played an integral part. Their prominent role was made possible by the expertise that had been acquired in the preparation of the regulatory analyses.

Appraising the effects of the Reagan administration's review procedures is more difficult, inasmuch as these are conducted mainly *in camera*. One thing is clear: Whether because of the changed perspective of the agencies or the changed approach of the review procedures, efforts to extend regulatory activities have been reduced abruptly. One important exception was the OSHA proposal, mentioned earlier, requiring the labeling of containers with hazardous materials. The cost of the hazard communication program over the years, it is estimated, would be $3 billion at present value. (A much more costly proposal had been made during the last week of the Carter administration despite the strong objections of the CWPS staff.)

More significant than the nature of the OSHA proposal was the substantive debate between the OMB and OSHA over the merits of the regulation. Since there is no public disclosure of the oversight activity, there is normally no external way of determining OMB's position. In this case, however, I was actively involved in this debate and was able to assess the merits of OMB's approach.[10]

OMB initially rejected the OSHA proposal because of OSHA's failure to demonstrate sufficient risk reduction benefits to warrant a $3 billion cost. More specifically, OMB correctly observed that OSHA had overassessed the cancer risks, had never shown that the existence of the warning labels would reduce the risks, and had failed to take into account the time lag before any reduction in cancer cases would occur. OSHA appealed this decision to Vice President Bush, who asked OMB and OSHA to explore these substantive differences further before making his decision.

The outcome of this policy debate was that the vice president approved the OSHA proposal after OSHA presented evidence showing that the standard was, on balance, beneficial. More specifically, although OMB's arguments were sound, OSHA had also underestimated benefits by measuring the medical costs that would be saved rather than the much larger value reflecting the avoidance of pain and death. In this case, the adjustment for the appropriate value of benefits offset the adjustments in the risk assessment.

This was an instance in which the oversight procedures led to the type of policy debate one would hope to foster in order to generate efficient regulatory policies. The actual outcome was far less important than the character of the oversight process. The policy discussion focused on the magnitude of the risk, the effect of the policy on the risk, and the value that society could reasonably place on such effects. The fact that both OMB and the regulatory agency were willing to discuss policies in these terms represented an advance over previous years. In these earlier years, too, agencies were prepared to calculate benefits and costs; but they were reluctant to engage in policy discussions which suggested that a balance between benefits and costs might be required.

Shortly after OMB's unsuccessful attempt to stop the OSHA regulation, there was a major reorganization of the OMB staff shifting the staff composition even further away from the mix of skills that are required to apply the benefit–cost approach.[11] Whether the same high standards exemplified by OMB's analysis of the OSHA hazard communication proposal will characterize future OMB efforts is unclear.

## IMPROVING THE OVERSIGHT PROCESS

There is a general consensus among supporters of regulatory reform that the review function still needs to be strengthened in some manner, particularly in its control of existing regulations.

### The Congressional Veto

A particularly visible trend has been the increased advocacy of the congressional veto.[12] The popularity of congressional veto proposals may be due in part to the failure of the White House oversight process to be more comprehensive. By excluding independent regulatory agencies, the present regulatory oversight mechanism has no jurisdiction over a major segment of regulatory policy. Congress has already begun to fill this gap by taking the initiative in influencing the policies of two independent regulatory commissions, the Consumer Product Safety Commission and the Federal Trade Commission.

The movement toward a congressional veto approach may also be inspired by the perception that the present oversight effort is not sufficiently stringent. These proposals also derive much of their appeal among business lobbyists from the increased opportunities they create for opponents of a regulation to block regulatory policies—by lobbying with Congress. Since congressional veto power by its very nature is not a tool that encourages a collaborative effort in developing new regulations, the net effect of the veto would undoubtedly be to decrease the number of regulations.

Although such diffusion of authority over regulations may ultimately be desirable, a more promising approach is to develop the capabilities of the present oversight structure more fully. My skepticism regarding the efficacy of a congressional veto is based in part on Congress's disappointing performance in structuring the legislation of the regulatory agencies, which in the case of the social regulation agencies impedes efforts to promote policies on the basis of their benefits and costs. The continued inability of Congress to reach a consensus on revisions in the Clear Air Act also underscores the difficulty that Congress is likely to have if it acquires broader regulatory authority.

### The Regulatory Budget

A possible expansion of the current oversight framework, suggested by some analysts, is the establishment of a regulatory budget.[13] According to this concept, OMB would assign each executive branch agency a budget for the amount of regulatory costs that the agency was allowed annually to impose on the economy. It should be noted at the outset that this focus on costs is not ideal, since benefits and costs should be considered. The cost components to be included would encompass not only the expenditures involved in implementing the regulations themselves but also the costs borne by the rest of society, including businesses and consumers. Agencies would be obliged to exercise their regulatory powers within that budgetary constraint, whether the costs were arising under their existing rules or under new programs.

The principal attraction of this approach is that it would impose a systematic form of discipline on regulatory agencies. The central budgetary institution, the OMB, is already in place, is relatively effective in controlling expenditure programs, and has had some success in regulatory oversight. To be sure, the regulatory costs that would be the subject of the OMB limits would not be the same as budgetary expenditures; but they would be similar in the sense that they represented estimated costs to society. That similarity suggests in part why President Reagan vested the oversight authority in OMB.

While the concept of a budgetary limitation merits serious consideration, one should be cautious in ascribing to it all of the prospective benefits that have been claimed by some of its more enthusiastic advocates.

For one thing, the estimates of social cost that go to make up a regulatory budget by their nature are much less precise than those that make up the usual expenditure budgets of government agencies. Estimates of consumer costs or business costs generated by some proposed regulation, for instance, are often only very crude guesses. Unlike the case of expenditure budgets, the regulatory budget is never tested against actual events; some elements of the regulatory budget remain estimates forever. Certainly some monitoring mechanism can and should be established to assess the costs of regulations; such estimates are implicit, for example, in any application of the benefit–cost approach. But the accuracy of the cost measures will never be as great as expenditure cost data; nor will the cost of acquiring the information be as low.

Clearly, the greatest shortcoming of the regulatory budget is that its advocates view the budget approach as a means of avoiding the difficult task of defining and estimating the benefits of alternative regulatory policies.[14] OMB needs only to set cost levels by agency, after which regulations will be designed by the regulatory agencies on a decentralized basis. Because benefits need not be considered, however, there is no assurance that, for any given expenditure level, agencies will select the most beneficial regulatory programs. Almost all CWPS analyses, for example, turned up possible regulatory approaches that were different in principle from those being proposed by the regulatory agency. Some quite innovative policy designs emerged during this period of CWPS oversight. Most noteworthy is the EPA "bubble policy" whereby EPA now regulates total emissions from polluting plants as if they were surrounded by an artificial bubble. Previously, each smokestack within the plant was subject to a pollution standard, imposing a larger cost on the firm than a system in which a firm could concentrate its efforts on pollutants that could be reduced inexpensively. By ignoring such issues of program structure, the pivotal role of regulatory oversight in fostering innovative approaches to regulation will be lost.

Even if agencies could be relied upon to pick their programs wisely, OMB could not establish meaningful regulatory budgets by examining costs alone. If regulatory budgets are ever to serve as more than an arbitrary form of political discipline, OMB needs some estimate of the benefits associated with different levels of expenditure.

### Expanding OMB's Oversight Powers

Some less radical modifications of the present oversight framework would go far to remedy the existing inadequacies in regulatory oversight. The principal weakness to be remedied in OMB's inability to influence the nature of regulations once they have been adopted. To be sure, OMB can designate specific regulations to be considered by the appropriate agency for possible termination; but there is no means for ensuring that the regulations will actually be reviewed and revised.

One possible means for creating more effective control is to give OMB the power to designate regulations for mandatory sunset review. This is a step that would appear on the surface to expand OMB's authority substantially. To respond effectively to such enlarged powers, OMB would have to develop a staff capacity to assess existing regulations on a retrospective basis and to review the sunset candidates. If such a review concluded that the regulation should be eliminated, however, it would be up to the agency administrator to take the necessary action, inasmuch as OMB has no legal authority to alter or abolish existing regulations. The resistance that agency administrators have shown to sunset proposals by OMB under the Reagan administration suggests that substantial political pressure from the White House would be required to generate any significant regulatory reform by this means.

An alternative approach that would be less selective in its choice of sunset targets is to fix an expiration date for each major regulation at the time it is issued. Agencies would be required to reassess the justification for the regulation periodically and to renew the regulations that survived the reassessment. To limit the analytical burden, the length of the period of validity could be varied according to the nature of the regulation, as could the level of analysis required for renewal.

A useful adjunct to any expanded oversight effort would be the development of independent sources of scientific data relevant to the many regulations pertaining to risk and the environment. At present, the participants in the review process seldom have the capacity to assess the accuracy of the regulatory agency's assertions, such as claims regarding the consequences of different exposure levels to cancer-causing materials. The regulatory agencies themselves usually summarize and interpret the available scientific evidence, and oversight groups are usually in no position to develop independent scientific evidence. A scientific support unit to which the OMB oversight unit could regularly turn would be a valuable resource for the oversight activity.

More generally, the government should pursue opportunities for greater independent funding of policy-related scientific research. The emphasis of present funding on contracts between researchers and regulatory agencies, which often have a strongly defined policy orientation, may produce less reliable scientific research then if the research funds were allocated by an independent agency, such as the National Science Foundation.

A final change would be to restore to the oversight unit the legal authority to file public statements before regulatory agencies that contained the unit's views regarding pending proposals. This change would foster greater public debate and accountability and would provide some assurance that OMB's actions were based on benefit–cost criteria and that these criteria were being applied objectively.

### The Need for Legislative Reform

Even with all such changes in place, it is questionable whether a dramatic improvement in regulatory policies would occur. For those like myself, who believe that the benefit–cost test should be a primary criterion in the selection of such policies, the change that would be produced in agencies with restrictive legislative mandates is likely to appear particularly slow.

These legislative mandates vary in content. But in the extreme instances, no comparisons are permitted between benefits and costs. The Delaney amendment to the Federal Food, Drug and Cosmetic Act of 1938 requires the Food and Drug Administration to prevent the use of all food additives that entail carcinogenic risks, irrespective of the level of the risk. The Clean Air Act specifically prohibits the Environmental Protection Agency from considering costs when setting air quality standards. In the case of OSHA, the agency is legally obligated to set standards that will "assure safe and healthful working conditions." While it has long been hoped that the courts would interpret the responsibilities of these agencies to include benefit–cost tradeoffs, in its landmark decision on the OSHA cotton dust standard, the U.S. Supreme Court ruled that OSHA's legislation prohibited benefit–cost tests for regulations pertaining to toxic hazards and harmful physical agents.[15] This outcome should serve as a general signal to those who were hoping that the judiciary would force regulatory reforms after Congress and the executive branch had failed to do so.

Unless these legislative mandates are changed through a modification of the enabling legislation of the agencies concerned with environmental risks, it is doubtful whether an oversight process or regulatory reform act can be fully effective. Any agency that is subject to legislative mandates may argue that it is obligated to pursue policies quite different from those advocated by the regulatory oversight group.

## THE FUTURE OF REGULATORY OVERSIGHT

The difficulties of regulatory reform can be traced to two fundamental problems. First, the restrictive legislation of many regulatory agencies has greatly impeded efforts by agency officials and outside critics to change these policies. Second, there has been no fully effective means for providing an independent check on these efforts.

Only with the changes instituted by the Reagan administration has there begun to be any effective control over regulatory activities, and then only with regard to new regulatory proposals. Any assessment of whether this greater control has improved policy outcomes is necessarily speculative because of the lack of any public record on the oversight process.

Once the issue of adequate authority is resolved, the desired focus of the oversight process will become a more salient issue. The emphasis of oversight has gradually evolved from a review of program impacts, to cost-effectiveness tests, to a benefit–cost test. The imposition of a benefit–cost requirement is by no means uncontroversial, wholly apart from its incompatibility with agencies' legislative mandates. Even if one espouses a benefit–cost criterion for policy design, as I have done here, there is the practical problem of estimating the magnitudes involved. These evaluation problems are endemic to debates over policies of all kinds, not simply those pertaining to regulation. An expanded and strengthened oversight unit will only provide the institutional context for raising these issues; it will serve to foster policy debate rather than eliminate it.

## APPENDIX

### Summary of Public Filings by the Council on Wage and Price Stability

A numerical summary of the CWPS filings from 1975 to 1980 is provided in Table A1. CWPS filings on behalf of the Regulatory Analysis Review Group are also included. The two agencies most frequently referred to in this article, the Environmental Protection Agency and the Occupational Safety and Health Administration, are shown separately. The number of filings averaged 50 per year, with roughly one-third of these analyses devoted to activities related to health, safety, or the environment, which are grouped under the risk regulation heading in the table. The number of nonrisk filings reached its peak in 1979–1980, a period in which deregulation efforts in transportation and energy were particularly active.

There also was a noticeable falling off in risk regulation activity beginning in 1978. This drop is not to be attributed to the impact of earlier CWPS filings in slowing down regulatory activity, but stems instead from uncertainty regarding the Supreme Court's interpretation of the agencies' legislative mandates. Moreover, the number of regulations may not be indicative of the actual level of regulatory activity, particularly for 1978.

An alternative measure of the volume of regulatory activity is the dollar costs they impose. I have made such a tally for all agencies engaged in health, safety, and environmental regulations. Similar estimates were not possible of other types of regulation, such as rate and entry regulations, since available cost data were not comprehensive in these cases. My cost estimates differ from other widely cited estimates of the regulatory burden, which are based on an assumed level of cost on the economy for each dollar in the agency's budget[16]; instead, mine are based on actual cost

**Table A1.** Council on Wage and Price Stability public sector releases regarding risk regulations, 1975–1980.[a]

| Agency | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | Total |
|---|---|---|---|---|---|---|---|
| EPA | 7 | 4 | 4 | 5 | 14 | 15 | 49 |
| OSHA | 2 | 4 | 5 | 2 | — | 1 | 14 |
| Other risk | 12 | 10 | 5 | 1 | 1 | 4 | 33 |
| Total risk | 21 | 18 | 14 | 8 | 15 | 20 | 96 |
| Total nonrisk | 31 | 35 | 30 | 28 | 36 | 46 | 204 |
| Total filings | 52 | 53 | 44 | 34 | 51 | 66 | 300 |
| Risk share of total | 0.40 | 0.34 | 0.32 | 0.24 | 0.29 | 0.30 | 0.32 |

[a] *Source:* Tabulations by the author using CWPS files.

**Table A2.** National costs of proposed risk regulations reviewed by the Council on Wage and Price Stability, 1975–1980 (range in billions of dollars).[a]

| | Year of proposal | | | | | | |
|---|---|---|---|---|---|---|---|
| Agency | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | Total |
| CPSC | | | | | | | |
| Low | | 1.1 | 2.3 | | | | 3.4 |
| High | | 1.8 | 3.4 | | | | 5.2 |
| EPA | | | | | | | |
| Low | 8.5 | 6.1 | 0.8 | 148.1 | 27.7 | 26.4 | 217.7 |
| High | 26.2 | 6.5 | 0.8 | 196.4 | 37.1 | 29.4 | 296.4 |
| FDA | | | | | | | |
| Low | 0.6 | .02 | 1.2 | | 0.9 | 0.3 | 3.0 |
| High | 0.6 | .02 | 1.2 | | 4.0 | 0.4 | 6.2 |
| NHTSA | | | | | | | |
| Low | 0.7 | | | 2.8 | | 11.1 | 14.5 |
| High | 1.4 | | | 2.8 | | 23.5 | 45.6 |
| OSHA | | | | | | | |
| Low | 17.3 | 2.7 | 4.4 | 69.2 | | | 93.6 |
| High | 17.3 | 2.7 | 24.1 | 448.2 | | | 492.3 |
| Other | | | | | | | |
| Low | 0.1 | | | | | 0.02 | 0.1 |
| High | 0.8 | | | | | 0.02 | 0.8 |
| Total | | | | | | | |
| Low | 27.2 | 9.9 | 8.7 | 220.1 | 28.6 | 37.8 | 332.3 |
| High | 46.3 | 11.0 | 29.5 | 665.3 | 41.1 | 53.3 | 846.5 |

[a] *Source:* Calculations by the author using CWPS filings and supporting data. All dollar figures are based on prices current in the designated year.

estimates for each regulatory proposal. To ensure comparability, I recalculated all estimates using a 10% interest rate and used the cost estimate for the policy actually adopted in cases where several options were considered.

Table A2 summarizes the cost levels for these agencies. In addition to EPA and OSHA, the agencies include the Consumer

Product Safety Commission (CPSC), the Food and Drug Administration (FDA), and the Department of Transportation's National Highway Traffic Safety Administration (NHTSA). EPA and OSHA are, as one might expect, the dominant agencies in terms of cost imposed. The wide cost range for OSHA, \$93.6–\$492.3 billion, stems from the open-ended nature of OSHA's 1978 proposal concerning its approach to carcinogen regulation. In terms of overall cost, 1978 was by far the most important year for risk regulations, even though there were few policy proposals.

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NOTES

1. An alternative perspective is provided by the current head of the Reagan oversight group, DeMuth, Christopher, "Constraining Regulatory Costs—Part I: The White House Review Programs." *Regulation, 4* (1980a): 13–26.
2. For a historical review of the evolution of regulatory policy, see Kahn, Alfred E., *The Economics of Regulation* (New York: Wiley, 1971), and MacAvoy, Paul, *The Regulated Industries and the Economy* (New York: W.W. Norton, 1979), who also addresses the role of regulatory oversight. Two recent series of essays covering a wide range of regulatory policies and their development are the series of CWPS's regulatory analysis edited by Miller, James C., III, and Yandle, Bruce, *Benefit–Cost Analyses of Social Regulation* (Washington, DC: American Enterprise Institute, 1979) and a series of essays edited by Wilson, James Q., *The Politics of Regulation* (New York: Basic Books, 1980).
3. For a comprehensive textbook treatment of the role that costs and benefits should play in the formulation of public policy, see Stokey, Edith, and Zeckhauser, Richard, *A Primer for Policy Analysis* (New York: Norton, 1978), especially Chaps. 9 and 13.
4. Executive Order No. 11821, November 24, 1974.
5. Office of Management and Budget Circular A-107, January 28, 1975.
6. Executive Order No. 12044, March 24, 1978.
7. This action seems to have been motivated more by a desire to terminate the CWPS pay/price standards program than to alter the regulatory oversight process. Abolition of the agency obviously had greater political appeal than scaling it down drastically.
8. The importance of taking policy actions before the stakes and stands of political players are established in a central theme of Model III in Allison, Graham, *Essence of Decision: Explaining the Cuban Missile Crisis* (Boston: Little, Brown, and Co., 1971).
9. The principal exception is the critical survey of research on the Occupational Safety and Health Administration by John Morrall, a leading official in the OMB and CWPS oversight efforts, *OSHA after Ten Years* (Washington, DC: American Enterprise Institute, forthcoming).
10. My involvement was that of an outside advisor called upon to settle the factual differences between the two agencies. My analysis of the OMB–OSHA dispute, which in turn became part of the substantive

debate over the regulation, is provided in Viscusi, W. Kip, "Analysis of OMB and OSHA Evaluations of the Hazard Communication Proposal," report submitted to Secretary of Labor Raymond Donovan, March 15, 1982. The influence of this report and the economic merits of the regulation on the final policy decision by Vice President Bush is discussed in the *New York Times*, March 23, p. 13 (national edition). That account is consistent with the favorable assessment that I provide of both the OMB oversight process and OSHA's regulatory analyses.

11. This reorganization occurred in May 1982. To maintain the illusion that there was no reduction of the economic analysis staff, a computer programming group was merged with the economics group to fill the vacancies left by the reduction in economists.
12. See Gilmour, Robert S., "The Congressional Veto: Shifting the Balance of Administrative Control." *The Journal of Policy Analysis and Management*, *2*(1) (Fall 1982): 13–25. One concrete legislative proposal along these lines is Senate bill S.1080, 97th Congr., 1st Sess., which was passed in 1982.
13. For a statement that gives much stronger support to the regulatory budget concept see DeMuth, Christopher, "The Regulatory Budget." *Regulation*, *4* (1980b): 29–43; and Lave, Lester, *The Strategy of Social Regulation* (Washington, DC: Brookings Institution, 1981). Lave and others credit Charles Schultze, Chairman of President Carter's Council of Economic Advisers, with development of the regulatory budget approach.
14. Lave (1981) and DeMuth (1980b) emphasize this factor and the ability to set in motion a decentralized process for making regulatory policy.
15. *American Textile Manufacturers Institute v. Donovan*, 452 U.S. 490 (1981).
16. This is the approach followed by Weidenbaum, Murray, *The Future of Business Regulation: Private Action and Public Demand* (New York: American Management Associations, 1979).

EXECUTIVE OFFICE OF
THE PRESIDENT
OFFICE OF MANAGEMENT
AND BUDGET

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# REGULATORY PROGRAM OF THE UNITED STATES GOVERNMENT

April 1, 1988 - March 31, 1989

# PART I. OVERVIEW AND SUMMARY

# PART I. OVERVIEW AND SUMMARY

## TABLE OF CONTENTS

Page
Introduction 4
The Problem 5
  The Growth of the Federal Regulatory Structure 5
  Costs of Federal Regulations 6
  Difficulties in Developing Regulations 6
  The Perverse Effect of Institutional Incentives 8
The President's Constitutional Duty to Oversee Agency Regulations 10
  Executive Power 10
  Nomination and Appointment of Officers of the United States 11
  Faithful Execution of the Laws 11
  Written Opinions from Executive Officers 12
The Mechanisms for Assuring Agency Adherence to the President's Regulatory Principles 13
  Institutionalizing Executive Regulatory Oversight 13
  Executive Order Nos. 12291 and 12498 13
  OMB Procedures for Implementing Executive Order No. 12291 15
Regulatory Policy Guidelines 16
  Policy Guidelines Requiring Economic and Analytic Justification 16
  Policy Guidelines Aimed at Producing Fair and Responsive Government 17
    Harnessing Market Incentives 18
    Reducing Burdens on State and Local Governments 20
    Streamlining Regulatory Procedures 22
  Summary 23
Making Federalism Work 24

Page
Federalism in Federal Rulemaking 24
  Providing Administrative Flexibility 24
  Promoting Efficiency Through Governmentwide Common Rulemaking 25
  Cutting Federal Red Tape 26
  Decentralizing the Decisionmaking Process 26
  Benefiting from State Views in the Development of Federal Rules 27
Listening to the States: Recommendations from the National Governors' Association 28
Federalism in the Future 29
  Institutionalizing Federalism: Executive Order No. 12612 29
  The National Governors' Association Project, Phase II 30
Summary 31
The Role of Economic Analysis in the Development of Responsible Regulation 31
  Ascertaining the Need for Federal Regulatory Action 32
    The Theory of Markets 32
    Alternatives to Federal Regulation 33
  Benefit/Cost Analysis 33
    Selection and Evaluation of Regulatory Options 33
    Benefit Estimates 34
    Cost Estimates 34
    Treatment of Risk and Uncertainty 35
  Discounting 35
  Critique of RIAs 36
  Summary 37

# *INTRODUCTION*

This is the fourth annual *Regulatory Program of the United States Government*, a product of the Office of Information and Regulatory Affairs. This report is in two parts. The bulk of it is in Part II, entitled "The Regulatory Program by Agency," and contains the regulatory programs for 1988–89 of 26 executive agencies. It is customary to precede this part of the report with a summary and, to some extent, a review of the overall Federal regulatory program. This year, Part I, entitled "Overview and Summary," summarizes the experience of eight years of effort to improve the system of Federal regulation.

The Office of Information and Regulatory Affairs (OIRA) is a part of the Office of Management and Budget (OMB) in the Executive Office of the President. OIRA was formally established in 1981 under the terms of the legislation known as the Paperwork Reduction Act of 1980.[1] OIRA's dual mission—to reduce the burden of paperwork requirements imposed by Federal agencies on the public (in the form of reports, questionnaires, and required documentation of all sorts), and to oversee the regulatory activity of the Federal agencies—has placed it at the focal point of much of what the Government does.

To some extent, institutionalized Presidential regulatory oversight constitutes a challenge to long-established relationships between the legislative branch and individual agencies, and between the Government and special-interest groups; and to the governmental behaviors that developed over the years as a result of them. The Reagan Administration was not the first to raise the challenge. As this report indicates, it has made this endeavor a major administrative effort.

In 1986, in recognition of the role of OIRA, Congress amended the Paperwork Reduction Act of 1980 to require that the Administrator of OIRA, who was previously appointed by the Director of OMB, be appointed by the President and be subject to Senate confirmation. This gives the Congress a substantial say over the selection of the Administrator and a more formal oversight role regarding the work of the Office. At the same time, the combination of congressional creation and Presidential appointment with Senate approval further confirms the role of the Office.

As the President states in his introductory message, it is important that the United States Government systematically and objectively establish governmentwide regulatory policies and priorities. The Federal regulatory structure is massive and complex. Over 100 Federal agencies regulate the public. Many agencies have overlapping responsibilities. Some duplicate the work of others; all have goals that differ from, and that are potentially inconsistent with, each other.

Federal regulations impose costs of over $100 billion annually on the American economy. These costs constitute a hidden tax, a compliance burden that is shifted from the entity regulated to the consumer, who pays higher prices or higher State and local taxes. This hidden tax can also be regressive, burdening poor people and smaller businesses disproportionately.

In addition, setting regulatory standards requires agencies to balance difficult and sensitive issues. Federal regulation, for example, cannot eliminate all safety, health, and environmental risks. As a result, federal regulators have to decide where to begin and where to stop, who should reduce what risks, how much the potential harm should be reduced, who should be held responsible, and how to establish and balance regulatory priorities in order to maximize the benefits to all. The piecemeal regulation of safety and health risks—calling for disparate costs of compliance to reduce equivalent amounts of risks—wastes economic and social resources, which, if applied on a consistent basis, would permit a much greater overall reduction of safety and health risk.

The President has therefore had a long-standing commitment to improving the system of Federal regulation to ensure that it is used rationally and effectively to better the lives of Americans. He directed that his Administration follow a basic set of regulatory principles, stating:

> In promulgating new regulations, reviewing existing regulations, and developing legislative proposals concerning regulation, all agencies, to the extent permitted by law, shall adhere to the following requirements:
>
> (a) Administrative decisions shall be based on adequate information concerning the need for and consequences of proposed government action;
>
> (b) Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society;
>
> (c) Regulatory objectives shall be chosen to maximize the net benefits to society;
>
> (d) Among alternative approaches to any given regulatory objective, the alternative involving the least net cost to society shall be chosen; and
>
> (e) Agencies shall set regulatory priorities with the aim of maximizing the aggregate net benefits to society, taking into account the condition of the particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future.[2]

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[1] 44 U.S.C. chapter 35

[2] Section 2 of Executive Order No. 1229, February 17, 1981 (46 FR 13193, February 19, 1981).

By establishing these regulatory principles and designating specific Administration officers as responsible to oversee agency compliance, the President institutionalized Presidential regulatory oversight for the Federal government. This Overview and Summary describes the problems the President faced, his obligation to act, and what he did to improve Federal regulation.

# *THE PROBLEM*

During the last half-century Americans have often turned to the Federal government to provide specific solutions to troublesome economic and social problems. As a consequence, Federal regulatory programs have been created as pragmatic answers to specific problems.

The number of problems which the Federal government was expected to solve grew rapidly, and so did the regulatory answers. In almost all cases, however, the regulations were narrowly targeted at specific problems, and developed without considering the cumulative impact of multiple, successive, sometimes inconsistent Federal regulations.

Thus, each new set of regulatory responses has tended to be a patchwork of isolated rules with little overall integration into the larger system of Federal law and policy, or long-term goals. In part, this has been because the long-term additive costs and structural dislocations have not been readily apparent at the time of promulgation. In part, it is because over time the cumulative effect of some regulatory programs has become excessively burdensome and counterproductive. For some programs the expected benefits never materialized or disappeared as conditions changed; for others the costs and adverse impacts far exceeded expectations. Moreover, as the number of regulations increased, it became apparent that the cumulative impact of many regulations could be far greater than the marginal impact of each individual regulation.

In some cases costs and uncertainties of regulation have deterred private investment in activities that are regulated, leading to reduced innovation and slower productivity growth. This may have compromised the market improvements the regulations had sought to achieve. For example, although food standards have become partially outdated by other regulatory developments, the old system has been perpetuated, inhibiting the use of new technical knowledge to develop innovative, nutritious products. Interstate Commerce Commission regulation of the trucking industry at one time established routes, service, and pricing. This slowed the development of alternate or complementary forms of transportation that might have created more flexible and efficient means of delivery. Outdated safety regulations that have been on the books for 17 years have prevented cheaper, more comfortable, and more protective personal equipment from being used by workers to protect themselves from injury.

The President's regulatory principles are designed to encourage Federal agencies to weed out and eliminate wasteful, unnecessary, intrusive regulatory standards, while encouraging the development of needed regulations that would increase the benefit to society as a whole. The increasing cost of regulations; their failure to keep up with changing social, economic, and technological conditions; their cumulative adverse effects on American society and its economy; and the basic need to fit regulations into the larger legal, social, and economic context led the President to issue his regulatory principles.

## THE GROWTH OF THE FEDERAL REGULATORY STRUCTURE

The Federal regulatory structure has grown dramatically in the last 50 years. The bulk of the *Federal Register* consists of notices of proposed and final rulemaking by Federal agencies: its size is a measure of the amount of government regulation. The *Federal Register* published 2,599 pages in 1936, 5,307 in 1940, and 15,508 in 1945. By 1975, the size of that year's publication had grown to 60,221 pages; by 1980, it had reached 87,012 pages. The *Code of Federal Regulations*, which codifies the official rules of the government, contained 9,745 pages in 1950; 22,877 in 1960; and 102,195 in 1980.[3]

By the early 1970s, Federal rulemaking had become a large part of the work of over 100 Federal agencies. These agencies were controlling major aspects of virtually the entire economy—overseeing the prices set by public utilities, determining the supply of agricultural products, setting the terms of labor contracts and conditions in the workplace, prescribing conditions of import and export, and specifying the nature and extent of pollution control and related environmental impacts.

This growth in government activity caused specific agency regulatory responsibilities to cut across functional areas subject to regulation by other agencies, creating overlap, conflict, and inconsistency. For example, today a wide variety of agencies review, approve, or inspect products for safety before they can be marketed for human or animal consumption. These include the Animal and Plant Health Inspection Service and the Food Safety and Inspection Service in the Department of Agriculture (USDA), the Food and Drug Administration in the Department of Health and Human Services, and the Offices of Pesticide Programs and of Toxic Substances in the Environmental Protection Agency. Similarly, the Offices of Air and Radiation, of Water, and of Solid Waste and Emergency Response in the Environmental Protection Agency (EPA), the Office of Surface Mining Reclamation and Enforcement in the Department of Interior, the Soil Conservation Service in the Department of Agriculture, and the Nuclear Regulatory Commission all set standards for reducing or cleaning up environmental pollution.

## COSTS OF FEDERAL REGULATIONS

Paralleling the growth in the number of Federal agencies and their regulatory activity was the growth in the cost of Federal regulation to American society. In general, there are two kinds of costs imposed by regulatory activity: the direct costs of administering the program, including government personnel, equipment, and supplies; and the indirect costs imposed on society as a result of changes in private activity necessary to comply with the newly imposed rules. The former costs are generally visible; they usually are directly stated in terms of congressionally approved budgets. The latter costs—the societal and economic costs—are much less visible, and often are neither assessed nor stated.

Rough estimates have suggested the burden of Federal regulations on the American economy ranges from 50 to 150 billion dollars a year, and the ultimate cost of the aggregate of Federal regulations is borne by individual consumers. These costs are often hidden. Issuing a regulation may impose relatively low direct costs upon the issuing Federal agency and may often impose little direct burden on the taxpayer, compared to the "hidden tax," a compliance burden that is shifted from the entity regulated (e.g., a business, hospital, college, State or local government) to the consumer who pays higher prices or higher State and local taxes. To the extent that Federal regulations raise costs for commonly used items, such as automobiles, food, toys, or other consumer goods, the "hidden tax" is more regressive than the Federal income tax.

In addition, regulations tend to burden smaller institutions (e.g., highly competitive, small-scale entrepreneurs and loosely organized labor groups) more and to burden larger institutions relatively less. Larger institutions hire experts to participate in the Federal regulatory process. Management of smaller organizations has to devote its own managerial skills and valuable time to regulatory problems rather than working on entrepreneurial or other gainful activities, thus imposing disproportionately higher opportunity costs upon those organizations.

Not only does the cost of Federal regulation have perverse impacts, but also these costs are not subject to the usual controls of the Federal government. Unlike expenditures carried out under Federal spending programs, the dollars spent to comply with Federal regulations do not travel to Washington and back again to the private economy. As a result, regulatory expenditures cannot be scrutinized through the usual disciplines of public finance such as taxation, appropriation, budgeting, and outlay accounting. Instead, those who have to comply—private parties and State and local governments—pay the compliance costs themselves. Indeed, in a period of fiscal stringency, regulatory expenditures are a politically expedient response to demands for various services. The fact that it is often easier for the Federal agency to spend private dollars through regulation than to spend public dollars through government programs suggests the need for special vigilance regarding this form of government spending.

For a variety of reasons the structural incentives to discipline regulatory costs are largely missing. While the benefits of Federal regulation are often directed at some specific subgroup, the costs of Federal regulation are largely hidden or spread out to so many people that the burdens are not, at first, readily apparent. In fact the cost to the consumer of any individual regulatory program may be relatively slight, while the benefits of a regulation for a particular interest group may be relatively high.

Thus those concerned with obtaining regulatory benefits will often have stronger incentives to protect those benefits than those who ultimately pay for these benefits will have to oppose them. Regulatory advocates will have every incentive to maintain vigilant support for the regulatory protection provided—the benefits are typically immediate and tangible, while the ultimate burdens imposed by regulations are often more diffuse. When the cumulative costs and adverse interactive effects of the aggregate of Federal regulatory programs become apparent, consumers who bear the ultimate cost burden may object. But when they do, they tend to object to an amorphous cumulation of adverse regulatory effects, not to the more focused disadvantages of individual identifiable regulatory programs.

## DIFFICULTIES IN DEVELOPING REGULATIONS

Early economic regulatory programs sought to ensure the provision of goods and services at fair prices. In some industries, such as the railroads and some forms of communications, the rationale was to prevent a perceived natural monopoly from charging prices higher than necessary to cover the legitimate costs of doing business. In other industries, such as airlines, the intent was to protect an infant industry. One method to accomplish these goals was to give Federal agencies legal authority to determine whether a given firm could enter a particular business, and if so, how much the firm could charge its customers.

By the 1970s, it had become clear that many of these economic regulatory programs did not achieve the goals that had led to their establishment. Significant technological development had eroded what formerly were natural monopolies. Numerous empirical studies demonstrated that price and entry control had raised, rather than lowered prices; and that such controls restricted, instead of promoted, competition and innovation in the American transportation and telecommunication industries. As a result President Reagan, as well as his predecessors, supported, and Congress approved, the economic deregulation of airlines and the partial economic deregulation of the trucking, railroad, bus, natural gas, and banking industries.

Social regulatory programs control various side effects of economic activity, particularly safety, health, and environmental hazards. Such programs may be needed because the marketplace does not always achieve the optimal degree of safety and environmental protection. Many private decisions made in the marketplace do not take into account all the social costs of pollution and other potential risks to society. Regulation can provide an incentive for the marketplace to take these factors into account.

Over the past 20 years with more sophisticated analytical tools available, Americans have been made more conscious of the unintended, unwanted side effects on safety, health, and the environment of many activities, effects that previously were simply ignored. Laboratory tests demonstrated that commonly used products such as saccharin or the dyes used in food coloring could induce carcinogenic effects in rats or mice. These effects were extrapolated to human populations. Sometimes direct evidence of carcinogenic effects in humans was observed, as with asbestos. But often the risk was theoretical and statistical and involved great uncertainty. Nevertheless, the public became concerned, and pressure built to regulate; to seek to reduce the harm, both real and potential, caused by these unintended side effects of otherwise productive economic activity. Congress began to enact broad regulatory enforcement programs.

These sweeping legislative mandates left the Federal regulatory agencies with difficult choices in administering their safety, health, and environmental regulatory programs. They had to decide where to begin and where to stop; what was to be regulated; how much should the harm be reduced; who should reduce the harm; who, if anyone in any meaningful sense, was responsible; and how to establish and balance regulatory priorities in order to maximize the benefits to all. Agencies were pushed to do this quickly, yet in accord with full administrative due process subject to likely (and actual) challenge in court.

These basic regulatory tensions were made even more difficult by the open-ended and sensitive nature of the regulatory programs involved.

First, changing technology and business behavior cause existing safety and health regulatory programs to be constantly expanding, even without any change in the scope of existing authorizing statutes. The commercial use and dispersion of chemicals, drugs, and food additives is constantly changing. For example, as new chemicals and chemical processes move from a few laboratories in a few central industries into small dispersed shops, plants, and factories, administrative controls grow to keep up with the dispersion of manufacturing activity.

Second, the scope of almost any social regulatory program is basically undefined and arbitrary. The sheer bulk of detail that is potentially subject to regulation for control of unintended, unwanted side effects is unlimited. For example, as more is learned about the chemicals contained in products, production processes, and waste streams, and as production machinery becomes more complex, the number of points where regulatory agencies intervene to reduce potential health and environmental hazards multiplies.

Third, the selection of which unintended, unwanted side effects to regulate (rather than ignore) is sometimes more arbitrary and emotional than rational. One of the most carcinogenic and unhealthy of general human activities is smoking.

> Epidemiologic studies have shown that cigarette smoking is responsible for more than 300,000 deaths each year in the United States. As [Surgeon General C. Everett Koop] stated in the Preface to the 1982 Surgeon General's Report, smoking is the chief avoidable cause of death in our society.[4]

Another of the most serious safety and health hazards is the drinking of alcohol.

> Alcohol contributes to many kinds of accidents and injuries and is involved in more than 50 percent of fatal automobile accidents. Drunk driving is the leading cause of death for persons in the 15–to–24 age group. About one-half of all single-vehicle crashes and two-thirds of nighttime single-vehicle crashes involve alcohol-intoxicated drivers.[5]

But these activities are popular, and consequently attempts to prohibit or severely restrict them in any meaningful way provoke strong opposition. The government will not prohibit a detrimental substance if that substance has a strong enough constituency.[6] If enough people want to, they are free to poison themselves and their friends. Instead, Federal regulators are instructed by the public and Congress to impose much more stringent control requirements on manufacturing activities few people understand, that may have relatively minor health effects, that may harm a relatively small number of people, or for which there is less popular support.

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[4] *The Health Consequences of Smoking: Nicotine Addiction*, a May 3, 1988 report of the Surgeon General, p. iii.

[5] "The fatality risk of smoking is more than 26 times greater than that of work. . . . [O]f the 565,000 deaths each year from heart disease, 170,000 result from cigarette smoking. Of the 412,000 deaths each year from cancer, 125,000 result from cigarette smoking, with more than 100,000 of these from lung cancer alone." *Economic Report of the President, January 1987*, pp. 184–85.

[6] *Economic Report of the President, January 1987*, p. 187.

Fourth, the determination of which safety, health, or environmental side effects to regulate (rather than ignore) and the balancing of costs against risk to human life is in fact so sensitive, yet so difficult, that the public, legislators, and agency regulators may try to avoid admitting that a problem exists. In some cases, any risk to human life is deemed unacceptable; in others, it is an accepted cost of doing business. For example, in advance of any large construction effort, such as building a suspension bridge or a skyscraper, any competent insurance company is able to estimate—on average, for a number of projects—how many workers will die or be severely injured in the course of construction. If this were not the case, the insurance company would not be able to set, in advance, a charge for necessary medical and liability insurance that is low enough to be competitive, yet high enough to earn a profit. While the Occupational Health and Safety Administration has issued a number of safety standards applicable to construction, no one has seriously proposed that construction activities be stopped. Thus the public, legislators, and government officials focus on only certain potentials for loss of life and not on others,[8] preferring to ignore the loss of life in some areas or at least through silence to avoid responsibility for it.

It is the case, then, that Federal, State, and local regulatory systems regulate some safety, health, and environmental hazards to the full potential of American technology, capital investment, and available regulatory enforcement staff. Other equally or more dangerous hazards are not regulated at all, while a number of hazards are regulated at least to some degree. This pattern is more the result of uncoordinated activity than of intentional social choice.

Such a disjointed and imbalanced regulatory structure is inefficient, ineffective, and unfair, both to those benefited and those being regulated. The haphazard regulation of safety and health risks—calling for disparate costs of compliance to reduce equivalent amounts of risks—wastes economic and social resources, which, if applied on a consistent basis, would permit a much greater overall reduction of safety and health risks.

Federal regulation cannot eliminate all safety, health, and environmental risks. As a result, the regulation of each particular safety and health risk has to be kept in balance and proportionate with the regulation of all other such risks. Otherwise there is great inconsistency and thus unfairness.

At its worst, case-by-case regulation of safety, health, and environmental risks can be counterproductive to the goals it seeks. For example, regulation of new drugs seeks to avoid the risks of marketing unsafe and ineffective new drug products. To do so, it inevitably delays the marketing of drugs that ultimately prove safe and effective. When numerous treatment alternatives are readily available, the risk of harm to public health from such delays is acceptable. When, however, a new drug shows promise against a serious and life-threatening condition such as AIDS, for which there is no established alternative, delay in introducing the product may harm, rather than enhance, public health.

Similarly, the environmental effects of new toxic chemical substances cannot be assessed in isolation. An admittedly dangerous chemical may represent a less risky alternative to an existing substance in widespread use. If so, strict regulation of new risks without considering the context of existing risks may prevent overall reductions in environmental risks. Likewise, workplace regulation of one hazard may draw resources from the control of other hazards which pose greater risks.

In addition, as Federal regulatory attention spreads to an ever-increasing set of "problems," the failure to keep costs imposed as low as feasible also means that other goals of society—not just safety, health, and environmental ones—are sacrificed unnecessarily. For example, to require excessive proof before a drug can be marketed can delay introduction of lifesaving drugs and deter investments in pharmaceutical research and development. The longer it takes for regulatory approval by a Federal regulatory agency, the less likely is the development of a new, improved product or a more efficient production process. The more business and private investment is diverted from research, development, and production facilities, the fewer jobs will be created, and the lower will be national income and growth.

Administrative efforts to resolve these issues have led to complicated risk assessment and risk management analyses based on estimates of exposure and actuarial trade-offs, comparisons of relative risk, and the equalization of marginal benefits and costs. While logically and analytically sound, at least in principle, such decisionmaking is neither widely understood nor popular with advocates of particular programs. Even asking the question "Is there a better way?" provokes an outcry from some advocates, tending to limit meaningful assessment of regulatory methods and needs.

## THE PERVERSE EFFECT OF INSTITUTIONAL INCENTIVES

The difficulties that are inherent in the development of sensible regulatory strategies are compounded by the vagaries of human nature and the innate dynamics of large Federal agencies.

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[8] For example, the risk of cancer from drinking one soft drink per day with saccharin is one-half the cancer risk from drinking one beer a day. Wilson & Crouch, *Risk/Benefit Analysis* (Cambridge, Mass., Ballinger, 1982), pp. 182–3. Yet saccharin, not beer, was what was banned.

First, regulatory agencies have a tendency to look for immediate results. Consequently they start to control undesired side effects by tackling the easiest and most understood problems even if these are not the most serious or hazardous. Because of a natural desire to show results, these problems are tackled by imposing fairly strict deadlines for accomplishing a solution.

Even when a new technique on the horizon promises much better control, institutional incentives do not permit the trade-off of doing a significantly better job tomorrow in exchange for a worse job today. This tendency arises in part because of the inherently short stay of most upper-level managers of agency staffs, who are in general advocates for the particular regulatory goal involved.

Second, this tendency for regulatory agencies to solve the known and manageable (rather than the perhaps more serious problem) is compounded by the tendency of regulatory agencies to be overly optimistic concerning the effectiveness of regulations in controlling private behavior. Regulatory agencies can usually affect only a few selected aspects of the problems they are charged with ameliorating. For example, an agency may decide to tighten a regulation that is not achieving the desired effect. If the problem is one of noncompliance or nonenforcement, however, the effect of making compliance more difficult may only worsen the problem.

Because of the uncontrollable aspects of these problems, and because regulated entities are able to adjust their behavior to accommodate regulatory specifics without necessarily accomplishing the regulatory goals, those regulated may respond in unexpected ways that undermine or even eliminate the expected benefits of a regulation. For example, child-proof tops on medicine bottles may be so difficult to open that users may prefer just to leave the top loose, thus undermining the basic purpose of the regulation. Also it is generally more convenient from an enforcement perspective for the government to regulate product or workplace design than it is to regulate human behavior. Accidents or unsafe practices, however, result from both design and behavior factors, and in many cases design standards may have a negligible effect on accident rates. For example, regulations required the installation of automobile seat-belts for years before anyone was required to use them.

Third, regulatory agencies are generally averse to risk, and have a tendency to be overly stringent in setting regulatory standards for products or production activities, even when faced with uncertain or incomplete information. Even if there is high scientific uncertainty, as with saccharin, the cautious approach for the one with regulatory authority is to act, rather than wait, and thus avoid facing the constituent and political criticism of being overly concerned with scientific and technical details, and of being callous or indifferent to human health. If a product, workplace, or behavior is deemed safe, nothing happens, and no one receives any unwanted attention. The agency is liable to receive a disproportionate share of the blame or criticism, however, when an accident or harm does occur.

Fourth, regulatory legislation has tended to favor well-organized special-interest groups at the expense of the general public. Legislative and agency regulatory policies often represent a series of compromises made in response to pressures from organized groups with the largest and most immediate stakes in the results. This advocacy form of representation almost always means that organized special interests petition government for preferential treatment and work hard to achieve special governmental advantages that may ultimately cost the country as a whole. Given existing budget constraints, and the difficulty in raising taxes, advocacy groups have also found it easier to accomplish their intended goals by having regulations direct certain groups to spend the money needed to accomplish the desired goals.

Moreover, an agency succeeds by accomplishing the statutory goals set for it as thoroughly as possible, and has every incentive to do only that. Thus, a bureaucracy will generally try to do its job but only its job. Agency personnel usually develop a strong allegiance to particular goals and often pay little attention to balancing single-purpose objectives against other competing goals. Primary agency constituencies naturally support "their" goals and oppose the goals of "others."

While agency personnel may seek to maintain their sphere of control, they may have insufficient knowledge to prescribe detailed solutions. Even if one assumes that careful study would reveal how best to achieve a regulatory objective at a particular moment in time, there is no reason to suppose that the same procedures would be correct one year, or even one month, later. When, however, the procedures that people and firms have to follow are prescribed by regulation, one can hardly update them any more frequently than that. Due process and administrative procedures require regulatory development to be slow and highly detailed. In situations in which technology and other relevant factors are changing rapidly, the likely outcome is that the procedures prescribed by regulation, even if reasonable to begin with, will quickly become obsolete.

In addition and acting as a block on regulatory improvement, those segments of the affected public that may benefit unfairly from an existing regulation will oppose any change. Many competitive advantages may come from the way a rule is written. For example, a regulation requiring that chemical exposure be reduced in the workplace may disproportionately affect small businesses. Similarly regulations increasing the cost of labor will benefit the more capital-intensive companies at the expense of those whose processes are more labor intensive. By having placed themselves into a good position under an existing regulation, some companies are in a better competitive position than one where the forces of the marketplace are allowed to operate or where a more sensible, evenhanded regulation is put in place.

Fifth, the dynamics of passing legislation itself may at times impede improvement of the Federal regulatory structure and instead provide incentives to continue the problems that are already evident. For example, a regulatory statute may be written to help an advocacy group by limiting entry to newcomers, or by holding prices and technological development at a fixed level. The economic benefits from such regulatory protection can be worth as much as a tax exemption or a direct grant, but are much less obvious as a political favor. But such specialized favors to one advocacy group may hurt American society and its economy disproportionately more than any benefit that may have been provided.

The fact that the passage of a regulatory statute tends to provide short-term political benefits and imposes costs more slowly makes this approach even more tempting. There is inevitably a lag between the time a statute passes and the time the economic costs and social restrictions are imposed. The "hidden tax" may take a while to become evident or even be identifiable. Given this inherent time lag, a legislator may be tempted to benefit a particular constituent by enacting some form of protective regulatory program, because, when the costs to the general public are finally apparent, he or she may no longer be in office and thus may avoid association with the costs of implementing the statute.

Sixth, there is a tendency for legislators who support a regulatory program to state its goals in absolute terms, such as "I favor clean air and pure drinking water; I am opposed to cancer." Stating regulatory goals in such absolute terms may provide good publicity and a favorable opinion among voters. On the other hand, an agency is seldom able to achieve results in such absolute terms, particularly given the costs of compliance involved. The legislative advocate may then be tempted to come back later and complain that the absolute goal was only partially attained.

This mixture of legislative goals (some hidden, some stated in absolute terms—piecemeal implementation based on which advocacy group received whose attention first and the administrative need to set practical priorities for enforcement—has led to a confusing and discordant regulatory structure.

# *THE PRESIDENT'S CONSTITUTIONAL DUTY TO OVERSEE AGENCY REGULATIONS*

Reflecting the proper role of the President and the President's responsibilities as Chief Executive, the Founding Fathers provided the President with the basic authority to oversee and coordinate the work of the heads of Federal agencies. As described more fully below, the Constitution gives the President the authority to manage the Executive branch; to supervise and guide Presidential appointees in the exercise of their executive functions; and to require their written opinions on matters within the scope of their responsibilities.

## EXECUTIVE POWER

*The executive Power shall be vested in a President of the United States of America* (Article II, Constitution of the United States). The Constitution vests the executive power in the President.[7] While the Founding Fathers understood that there would be Federal agencies responsible for the day-to-day implementation of Federal law, they clearly and consciously chose an independent executive over a collegial body subject to legislative direction.[8]

The Constitution makes the President accountable to the people—the electorate—for the work of the Federal government. The President is the only official given executive authority by the Constitution and the only elected official (besides the Vice President) to be elected by all of the people. The President is therefore the only Federal official accountable to the country as a whole for the administration of the totality of Federal law and of the Nation's regulatory policy.

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[7] "The executive power under our Constitution . . . is not shared—it rests exclusively with the President." *Sierra Club v. Costle*, 657 F.2d 298, 405 (D.C. Cir. 1981).

[8] See, generally, Strauss, "The Place of Agencies in Government: Separation of Powers and the Fourth Branch," 84 Col. L. Rev. 573 (April 1984); Pierce, "The Role of Constitutional and Political Theory in Administrative Law," 64 Tex. L. Rev. 469 (1985); Strauss and Sunstein, "The Role of the President and OMB in Informal Rulemaking," 38 Ad. L. Rev. 181 (Spring, 1986); DeMuth and Ginsburg, "White House Review of Agency Rulemaking," 99 Harv. L. Rev. 1075 (1986); Cross, "Executive Orders 12,291 and 12,498: A Test Case in Presidential Control of Executive Agencies," 4 Journal of Law & Politics 483 (1988).

On the other hand, as a practical and constitutionally implicit matter, the President does not generally execute Federal regulatory law; heads of Federal regulatory agencies do. Congress, by statute, typically provides legal decisionmaking authority directly to heads of agencies and to the heads of components within agencies. But this convention cannot and does not relieve the President of accountability to the public for the way in which heads of agencies execute the law, and for the way in which the Government implements regulatory policy.

Because the President is politically accountable for what others do, the President is obligated by the very nature of his or her position to supervise them—to make them work together in ways consistent with overall Presidential policies. Specifically and within the discretion and authority provided by existing law, the President is obligated to allocate resources, set priorities, and coordinate the activities of the heads of different regulatory agencies—all in order to assure that the Federal government operates in a coherent and efficient way.

## NOMINATION AND APPOINTMENT OF OFFICERS OF THE UNITED STATES

*The President . . . shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . all other Officers of the United States, . . . . He . . . shall Commission all the Officers of the United States* (Article II, Constitution of the United States).[8] The President appoints at least the head of any regulatory agency. Presidential appointees are generally part of the Executive branch; that is, they work for the President, and generally can be removed by him for any reason, or for no reason at all.

One source of the President's power to manage subordinates arises from the President's ability to remove those appointees in whom he or she lacks political confidence or, less broadly, who disobey his or her valid instructions. If the President wishes particular decisions to be made by a recalcitrant subordinate, the President's recourse is to discharge the relevant official and to appoint a new one who shares his or her inclinations.

Presidential authority over appointees is not absolute. Ultimate legal decisional authority may lie in particular cases in the regulatory agencies. The President may not be legally empowered to make particular decisions statutorily vested in subordinate officials—except to the extent the possibility of a removal may influence such a decision.

Basically, however, agency heads exercise their statutory authority at the President's pleasure, and have done so since the beginning of the Republic. As the size of government has grown, Presidents of both parties have structured working relationships in the Executive branch (by Executive Orders or other instructions), so that they may continue effectively to supervise and guide subordinate officials in the performance of their duties.

## FAITHFUL EXECUTION OF THE LAWS

*The President . . . shall take Care that the Laws be faithfully executed* (Article II, Constitution of the United States). As Chief Executive, the President is constitutionally responsible for the day-to-day implementation of all Federal laws by Federal agencies. This gives the President the responsibility and with it the commensurate authority to oversee the development of regulations by Presidential appointees.

The existence of a single executive, politically accountable to the people faithfully to execute the laws, locates the coordination and dispute resolution function in the Presidency. Given the President's political accountability and constitutional responsibility, the President is uniquely placed to oversee regulatory policy in a way that is responsive to the interests of the public as a whole. Agency officials, in contrast to the President, are only indirectly accountable to the public. They may also be subject to more parochial pressures from individual advocacy interests and agency staff. For these reasons, a supervisory role by the President helps ensure that discretionary decisions by regulatory agencies are responsive to the needs of the general public.

Guiding the Federal government, with all of its various agencies and detailed legal authorities, is a difficult and complex task. Diverse Federal agencies implement many laws. Such multiple responsibilities inevitably raise questions of priority, conflict, and coordination that rarely are resolved in the statutes involved. That the legislature may create a statute and order its implementation does not mean that the legislature will provide funding adequate to carry it out; will fully anticipate the indirect, possibly adverse, effects of "full" enforcement; or will understand the indirect impacts of the statute on all others in force. Particular agencies, with their specifically focused responsibilities, may be indifferent or even opposed to the need for coordination.[10]

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[8] An appointment places an individual into a Federal position; the commission defines the scope of authority to carry out that position, and the terms on which that position may be retained. For example, on September 11, 1789, President George Washington commissioned Alexander Hamilton to be his Secretary of the Treasury. In so doing, he wrote:

> I have nominated, and by and with the advice and consent of the Senate, do appoint him Secretary of the Treasury for the said United States, and do authorize and empower him to execute and fulfil and the Duties of that Office according to Law, and to have and hold the said Office, with all the Powers, Privileges, and Emoluments, to the same of the Right appertaining, during the pleasure of the President of the United States for the time being.

On September 26, 1789, President Washington commissioned Thomas Jefferson to be Secretary of State, likewise "during the pleasure of the President of the United States for the time being." Cf. Cross, "Executive Orders 12,291 and 12,498: A Test Case in Presidential Control of Executive Agencies," 4 Journal of Law & Politics 483, 503–04 (1988).

In addition to the obligation to resolve conflicts and set priorities among statutes, the President also needs to coordinate the implementation of all Federal law with the President's political program that the voters elected him or her to carry out, and to mold both to changing circumstances. The day-to-day course of national affairs generates new issues to which the President must make a coherent response and for the resolution of which the public will hold the President politically accountable.

This need to coordinate and oversee agency regulatory and other activities requires the President to build ongoing relationships with all agencies, based on substantial lines of communication and guidance to the appointed officials. Reciprocally these officials need to maintain relations with the President consonant with the President's obligation to see to the faithful execution of the laws.

The President, given his or her capacity for centralization, is able to energize and direct regulatory policy in a way that would be impossible if that policy were to be set exclusively by agency officials. An agency-by-agency approach to regulation does not permit a useful evaluation of tradeoffs between legitimate but nonetheless competing objectives. Leaving balancing functions in the agencies would create multiheaded government, government with neither the capacity to come to a definitive resolution nor the ability to see that any resolution is honored in all agencies to which it may apply.

Over the past ten years and before, it has been the Presidential role to seek information and provide it to Federal regulatory agencies in order to promote coordination and awareness of national regulatory policy issues, to require agency analyses and agency responses on national policy concerns relevant to the agency's regulatory responsibility, and to direct that given perspectives be further considered in implementing regulatory policy. Given the overall problems with the Federal regulatory structure, it has been the President and officials in his Executive Office who have asked such questions as: Are there better and more effective regulatory approaches than the shopworn schemes of the past? Are the full costs of government regulatory programs well understood? Are they reasonable in relation to the benefits they produce? What is the cumulative impact of all regulatory programs on the country's economy?

## WRITTEN OPINIONS FROM EXECUTIVE OFFICERS

*The President . . . may require the Opinion, in writing, of the principal Officer in each of the executive Departments, upon any Subject relating to the Duties of their respective Offices, . . .* (Article II, Constitution of the United States). The Founding Fathers specifically obligated the heads of agencies to respond to requests from the President for opinions in writing. These reports may be demanded in private, preliminary to agency action in time for relevant response on the President's part, and in a form that the President is able to specify—for example, an explanation of reasons behind proposed courses of action, a plan for undertaking an intended rulemaking, a benefit-cost analysis, or a regulatory agenda, calendar, or program.

The Presidential managerial oversight required by the Constitution goes back to the first days of the Republic. Since 1789, agency heads have sought and received prior advice from the President and officials in his Executive Office on important executive actions.[11] Such Presidential communication, coordination, and direction are the essence of executive managerial oversight, just as reauthorization and appropriations hearings are the basic oversight tools for a legislature.

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[10] Such centralized regulatory oversight efforts are naturally opposed by individual program advocates and those in an agency that agree with such program advocates. Advocates that stand to benefit from allocation of resources to "their" issue would prefer to have policy direction and regulatory planning authority rest exclusively in "their" program agency. Such advocacy groups would then have greater opportunity to shape the outcome of a rulemaking to their liking through years of prerulemaking orchestration of agency staff, congressional staff, and the trade press.

[11] For example, President Thomas Jefferson reported approvingly that President George Washington had routinely reviewed the correspondence prepared by his cabinet officials before it was mailed, a practice that President Jefferson resumed:

> Having been a member of the first administration under Gen. Washington, I can state with exactness what our course then was. Letters of business came addressed sometimes to the President, but most frequently to the heads of departments. If addressed to himself, he referred them to the proper department to be acted on: if to one of the secretaries, the letter, if it required no answer, was communicated to the President, simply for his information. If an answer was requisite, the secretary of the department communicated the letter and his proposed answer to the President. Generally they were simply sent back after perusal, which signified his approbation. Sometimes he returned them with an informal note, suggesting an alteration or a query. If a doubt of any importance arose, he reserved it for conference. By this means, he was always in accurate possession of all facts and proceedings in every part of the Union, and to whatsoever department they related, he formed a central point for the different branches, preserved an unity of object and action among them; exercised that participation in the suggestion of affairs which his office made incumbent on him; and met himself the due responsibility for whatever was done. During Mr. Adams' administration, his long and habitual absences from the seat of government, rendered this kind of communication impracticable, removed him from any share in the transaction of affairs, and parcelled out the government, in fact, among four independent heads, drawing sometimes in opposite directions. That the former is preferable to the latter course, cannot be doubted. It gave, in deed, to the heads of departments the trouble of making up, once a day, a packet of all their communications for the perusal of the President; it commonly also retarded one day their dispatches by mail. But in pressing cases, this injury was prevented by presenting that case singly for immediate attention, and it produced us in return the benefit of his sanction for every act we did. T. Jefferson, *The Complete Jefferson*, 306–07 (S. Padovr ed. 1943).

# *THE MECHANISMS FOR ASSURING AGENCY ADHERENCE TO THE PRESIDENT'S REGULATORY PRINCIPLES*

Given the ongoing and increasingly serious problems with the Federal regulatory structure, and the President's constitutional responsibility to manage and oversee Federal regulatory actions, President Reagan set in motion a regulatory program to ensure greater coordination, more analysis of possible regulatory impacts, more administrative rationality, more public notice of proposed Federal regulation, and increased Executive involvement in the regulatory process.

## INSTITUTIONALIZING EXECUTIVE REGULATORY OVERSIGHT

President Reagan was not the first modern Chief Executive to concern himself with the disorder in the regulatory programs of the Federal government. In 1971 President Nixon established in the Executive Office of the President a "Quality of Life" review of certain regulations. As a result, the Office of Management and Budget (OMB) Memorandum implementing this review process required agencies that promulgated rules in the environmental, health, and safety regulatory areas to coordinate their regulatory activities with other Federal agencies.[12] In 1974 President Ford issued an Executive Order to require agencies to prepare, and OMB to review, inflation impact statements for major agency rules.[13]

In 1978 President Carter implemented various actions to strengthen executive regulatory oversight. First, he issued an Executive Order requiring detailed regulatory analyses of proposed agency rules and review by the Executive Office of the President.[14] Second, he created the Regulatory Analysis Review Group, which comprised representatives from the principal Federal economic and regulatory agencies. The purpose of this group was to examine in detail a limited number of regulatory analyses with substantial economic impact. Third, in October 1978 President Carter created the Regulatory Council, a group consisting of the heads of Federal regulatory agencies. The Council's principal function was to develop and publish semiannually the *Calendar of Federal Regulations*, which provided analytical synopses of 120–180 major regulations under development that were likely to have substantial economic or public impact, and assisted the regulators in developing cost-effective and consistent regulations.

Building on this experience, but going substantially beyond it, President Reagan put in place two major Executive Orders to ensure more systematic executive oversight of agency regulatory developments. The first, issued in 1981, instructed the regulatory agencies to demonstrate the likely benefits and costs of a regulation to Executive Office officials before the agencies could issue the regulation. The second, issued in 1985, mandated the annual *Regulatory Program of the United States Government*. This was designed to improve agency regulatory management by providing the President and his political appointees direct opportunity to review major regulatory activities for the coming year, to focus the Administration's regulatory priorities, and to coordinate with each other.[15]

These oversight mechanisms permitted the President to balance and coordinate Federal regulatory policy, providing a perspective that could only come from a single Chief Executive. To implement these two Executive Orders, the President directed officials in his Executive Office to carry out the needed coordination and oversight of the development of agency regulations. These Orders are modelled on the role of the Office of Management and Budget in the development of the fiscal budget. In both areas, a central task is to ensure that potentially conflicting and inconsistent proposals are assessed and ultimately reconciled. In both cases, the President, through officials in his Executive Office, is able to supervise the decisionmaking process. And in both settings, the budgetary model is a device for increasing (and exposing to public view) control by agency heads over agency staff decisionmaking. This Executive regulatory oversight process ensures early involvement of the politically accountable officials in the agencies.

## EXECUTIVE ORDER NOS. 12291 AND 12498

Today Executive Order No. 12291 (see Appendix I for full text) is the backbone of Executive regulatory oversight activities. In it President Reagan instructed his appointees to follow his regulatory principles. To assure that they did, he also instructed them to submit all of their proposed regulations to OMB prior to issuing them.

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[12] October 5, 1971 memorandum for the Heads of Departments and agencies entitled "Agency regulations, standards, and guidelines pertaining to environmental quality, consumer protection, and occupational and public health and safety," from OMB Director George P. Shultz.

[13] Executive Order No. 11821, 39 FR 41501 (November 29, 1974), extended by Executive Order No. 11949, 42 FR 1017 (January 5, 1977).

[14] Executive Order No. 12044, 43 FR 12661 (March 24, 1978).

[15] For a more detailed description of the historical background for these Executive Orders, see a chapter in the 1987 *Regulatory Program of the United States Government*, entitled "Executive Regulatory Oversight of Federal Regulation and Regulatory Paperwork" (pp. xxxii to li).

Within OMB this regulatory review authority is carried out by the Office of Information and Regulatory Affairs (OIRA).[16] That Office reviews agency draft rules to ensure that the President's regulatory principles are being carried out. If they are not, that Office returns the rules to the agency for further work by the agency to make them consistent with those principles.

OMB does not have a veto over the rulemaking actions taken by agency heads under the statutory rulemaking authority assigned to them. This keeps the statutory prerogatives of the agency heads intact. OMB reviews the draft agency regulation for consistency with the President's regulatory principles, to identify possible issues of concern, and to review them for the President. If in working with the agencies, OMB and the agency head disagree, OMB or the agency head are always able to take the issue to an appropriate cabinet body, and as appropriate, to the President himself, in order to resolve it.

By 1985 it became obvious that more could and should be done. Despite OMB review of agency draft regulations and despite the mammoth expenditures Federal regulations exacted from some and the benefits they gave to others, Federal regulations were still being managed far less systematically than direct government spending.

The inadequacy in regulatory oversight was caused by the length of time required to develop many of the more important Federal regulations and by the ability of agency program advocates to build a public constituency supporting a draft regulation before agency and Executive office management had a full opportunity to focus on its implications. Agency staffs would often spend considerable time and invest substantial effort in hearings and in developing a factual record and special-interest support for these regulations. Millions of dollars in contract or other studies might be invested. Then, because review under Executive Order No. 12291 occurred at the very end of the regulatory development process, the rule would first be seen by the agency head, and then shortly after by OMB. This pattern of regulatory development made it very difficult to have agencies prepare the kind of analyses that the President and several of his predecessors thought should be brought to bear on those rules to help coordinate and focus agency decisionmaking.

As a result, President Reagan decided he needed to involve agency heads, policy officials, and the public earlier in the rulemaking process. On January 4, 1985, he issued Executive Order No. 12498, "[i]n order to see that the laws are faithfully executed, and that the policies of this Administration are reflected in the regulations issued under those laws."[17] (The full text of this order is included in Appendix II.)[18]

He called on his Administration every year to publish a Regulatory Program. In issuing this Executive order, however, President Reagan did not just direct his Executive Office to publish a book. His Executive order established an annual regulatory planning process. Each major regulatory agency drafts at the beginning of each year a summary of its regulatory policies, and a list of specific regulatory development projects under way. OMB then reviews each agency's draft regulatory program on behalf of the President. OMB reviews each one for consistency with the Administration's regulatory policies and priorities and the draft regulatory programs of other agencies. OMB will also identify further regulatory or deregulatory actions that are necessary to achieve consistency with Administration policy. If OMB and the agency cannot resolve a policy dispute, it is referred to an appropriate forum in the White House and, when necessary, to the President himself. Following this Executive review, the Administration publishes its decisions in the Regulatory Program.

The 1988 Regulatory Program, of which this overview is a part, sets forth for each agency its objectives for the 1988 Program Year (April 1, 1988—March 31, 1989), what issues the agency believes require immediate attention, and what the agency is doing to ensure the cost-effectiveness of the alternatives it proposes. If an agency later asks OMB to review an important rulemaking that was not included, but that should have been, OMB may return it to the agency for further work and for inclusion in the next year's Regulatory Program.

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[16] OIRA was established in January 1981 as required by Section 3503 of the Paperwork Reduction Act of 1980 (Public Law 96–511). S. Jay Plager, the present Administrator of OIRA, is the fifth to hold that position since its establishment in 1981. He was preceded by James C. Miller III, now Director of OMB and a member of the President's Cabinet; Christopher DeMuth, now President of the American Enterprise Institute in Washington, D.C.; Douglas H. Ginsburg, now Judge of the U.S. Court of Appeals for the District of Columbia; and Wendy Lee Gramm, now Chairman of the Commodity Futures Trading Commission. Under the Paperwork Reduction Act, as amended by the Paperwork Reduction Reauthorization Act of 1986, OIRA is responsible for reviewing, approving, and disapproving collections of information imposed on the public; providing principles, guidelines, and guidance concerning the acquisition, use, and management of Federal information resources (including computers and telecommunications); and coordinating and giving policy direction in Federal statistical activities. OIRA is also assigned responsibilities under the Budget and Accounting Procedures Act of 1950, as amended (statistical policy, 31 U.S.C. 1104(d)), the Brooks Act (Public Law 89–306, as amended), the Privacy Act of 1974 (5 U.S.C. 552a), and Executive Order No. 12046 (Telecommunications Policy, March 17, 1978).

[17] The Regulatory Message of the President, 1985 *Regulatory Program of the United States Government* (p. vii).

[18] The Administration has published Regulatory Programs for 1985, 1986, 1987, and now, 1988.

The Regulatory Program, in conjunction with the Executive Order No. 12291 review process, serves a number of purposes. The Regulatory Program provides a formal mechanism by which to involve agency heads, policy officials, and the general public early in the rulemaking process. With these publications, the Administration has presented, for the first time for all to see, a comprehensive Administration program of upcoming regulatory policy. Annual publication permits Congress and the American people to understand more fully the Executive's regulatory choices and its priorities: to understand more fully at an earlier stage, before the publication of any proposed rule, how the Executive intends to exercise the regulatory discretion that Congress has provided it by statute.

In addition, this Executive order enhances the agency head's effective control over his or her staff. By providing agency heads an annual opportunity to focus on the work of their agencies in a planning rather than a reactive mode, stressing broad vision and priority settings and involving them early enough, agency heads can have a greater impact on the regulatory options proposed. Given the required procedures for coordination, agency heads can better determine whether a particular regulatory action is worth starting before committing agency resources to it, and whether the regulatory activity is consistent with Administration policy.

The personal involvement of agency heads in regulatory policymaking also enhances their accountability to the President for the regulatory choices they make. Scarce government resources must be allocated according to some set of priorities. Given his Constitutional responsibilities, the President decided that regulatory priorities should not be determined unilaterally by each agency. Rather these priorities should be selected by the President's Administration as a whole, through a process that takes into account a wide spectrum of agency demands and Presidential policies. As President Reagan stated in issuing Executive Order No. 12498, each agency is to become "accountable for the management of the regulatory process, to ensure that policy options are not narrowed prematurely and that each significant regulatory proposal will be considered in relation to the others."[19]

## OMB PROCEDURES FOR IMPLEMENTING EXECUTIVE ORDER NO. 12291

In order to ensure that the public and the Congress are fully informed of the Administration's regulatory policies, OMB/OIRA has adopted procedures to:

> maintain two type[s] of documents in our public files relating to regulatory reviews—all comments received from any member of the public, and all our final recommendation letters to agencies under Executive Order No 12291. These files will also be accessible to the public in the reading room during normal business hours.[20]

Furthermore, in accordance with disclosure procedures adopted by OIRA on June 13, 1986, OIRA will disclose and publicly release upon request material provided to it by the agencies for Executive Order No. 12291 review, including the draft rules themselves.[21]

In addition, OIRA has agreed with several agencies (the Department of Housing and Urban Development, Labor, Transportation, the Treasury, and the Environmental Protection Agency) to additional disclosure procedures. Under these procedures, whenever the Administrator or Deputy Administrator of OIRA acquires factual information regarding an ongoing rulemaking as a result of a telephone call or a meeting, he or she will communicate that information to the agency's General Counsel and advise the General Counsel of the source of the communication. In addition, on the rare occasions when a meeting is scheduled to discuss a rule with persons who do not work for the Federal government, agency officials will be invited to attend. Furthermore, OIRA will send to the agency copies of all written information pertaining to these rules that it receives from persons outside the Federal government.[22]

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[19] "Development of Administration's Regulatory Program," Presidential Memorandum for the Heads of Executive Departments and Agencies, dated January 4, 1985 (see Appendix II).

[20] May 30, 1985, memorandum, entitled, "OIRA Procedures #3," from the Deputy Administrator to OIRA Staff, p. 5. See Memorandum for the Heads of Departments and Agencies Subject to Executive Order Nos. 12291 and 12498, entitled, "Additional procedures concerning OIRA reviews under Executive Order Nos. 12291 and 12498 [Revised]," from Wendy L. Gramm, Administrator, OIRA, dated June 13, 1986, procedure #11 [hereinafter, referred to as "OIRA Disclosure Procedures #11"]. See Appendix III.

[21] See OIRA Disclosure Procedures #1, #2, #3, and #10, in Appendix III. OMB has generally not made similar materials publicly available that are developed by the agencies or OMB in other Executive review processes because they are deliberative documents and predecisional in nature and are not required by the Freedom of Information Act to be released. As a general matter, such disclosure would chill the full and frank interchange of views between the President and his appointees that is critical to the effectiveness of the policy formulation process. OMB's ability to withhold E.O. 12291 review material under the Freedom of Information Act has been upheld. (Memorandum Opinion in *National Tank Truck Carriers* v. *OMB*, C.A. No. 82-93 (D.C.D.C., May 28, 1982)).

OIRA has also—as a matter of policy—restricted its discussions, meetings, and other contacts with persons outside the Executive branch on rules under Executive Order No. 12291 reviews. Only the Administrator and the Deputy Administrator of OIRA may meet or discuss a rule under Executive Order No. 12291 review, unless they specifically authorize some other individual in OIRA to do so.

[22] See OIRA Disclosure Procedures #4 to #7, and #11, in Appendix III.

# *REGULATORY POLICY GUIDELINES*

In addition to creating a process to improve Executive coordination of agency regulatory decisions, Executive Order No. 12291 sets out President Reagan's governing goals for the agency regulatory programs. These Presidential regulatory principles are complemented by regulatory review requirements which, to the extent permitted by law, require agencies to assess the benefits and costs of their regulations and to attempt to achieve the greatest net social benefits in making their decisions. As experience with Executive Order No. 12291 accumulated, the Administration refined these policies and developed a set of ten Regulatory Policy Guidelines to assist agency regulatory analysis in the rulemaking process.[23]

The ten guidelines attempt to address the most frequently encountered issues in Federal regulation and guide the agencies in the administration of regulatory programs. Of necessity their application is subject to the caveat that this type of analysis is not precluded by law. The guidelines make clear that a significant obstacle to making many regulations more rational is the language of the statutes themselves. For example, statutes sometimes require uniform national engineering standards when far superior policies for attaining the goal sought are available, or they require severe restrictions or prohibitions of certain products without considering the total public health consequences.

For analytical purposes, the ten Regulatory Policy Guidelines can be divided into two categories: those that address economic and analytic justification for regulatory proposals, and those that suggest the particular types of strategies or regulation that are most likely to produce fair and responsive government.

## POLICY GUIDELINES REQUIRING ECONOMIC AND ANALYTIC JUSTIFICATION

> Regulatory Policy Guideline No. 1:[24] Regulations should be issued only on evidence that their potential benefits exceed their potential costs. Regulatory objectives, and the methods for achieving these objectives, should be chosen to maximize the net benefits to society.

The first guideline restates the basic principles of Executive Order No. 12291. It applies to all kinds of regulation: economic (the regulation of markets and economic relationships); social (health, safety, and environmental regulation); and administrative (the management of Federal funds and resources).[25]

As with Executive Order No. 12291, this guideline is to be used only "to the extent permitted by law." Executive branch policies cannot override explicit statutory directions. Some regulatory statutes direct certain actions regardless of costs, benefits, or both. On the other hand, where there is policy discretion the President has a Constitutional responsibility to provide guidance to the departments and agencies in exercising the discretion they do have.

The point at which a given regulation's benefits exceed its costs can be a matter of uncertainty and controversy.[26] A Regulatory Impact Analysis (RIA) is required by Executive Order No. 12291 for "major" regulations and is to contain a benefit-cost analysis for such proposed regulatory actions.[27] In recent years there have been a number of agency RIAs that contained carefully prepared analyses in support of major regulatory initiatives and demonstrated net benefits that were clearly positive, for example, the RIAs analyzing the Department of Transportation's (DOT's) center high-mounted stop-lamps, the Environmental Protection Agency's (EPA's) lead phasedown, and the Occupational Safety and Health Administration (OSHA's) fall protection regulations.[28]

DOT issued its regulation requiring automobiles to have a center high-mounted stop-lamp in 1983. DOT first conducted extensive analyses estimating the potential benefits and costs. To do so, DOT conducted several experiments in which fleets of automobiles were equipped with various types of stop-lamps in order to measure their relative effectiveness in reducing rear-end collisions. This regulation is one of the most highly visible success stories of the Administration's regulatory reform program. These stop-lamps are seen almost every time one follows an automobile manufactured since 1986.

EPA's lead in gasoline phasedown rule was also accompanied by extensive and high-quality economic analysis that clearly established that the benefits of lead phasedown exceed the costs.[29] This regulation has been applauded by public health specialists, environmentalists, and consumers.

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[23] These Regulatory Policy Guidelines were set forth in the August 11, 1983, Report of the Presidential Task Force on Regulatory Relief.

[24] These Regulatory Policy Guidelines do not appear in numerical order in this text. They are given the same numerical designations as they were given in the August 11, 1983, Report of the Presidential Task Force on Regulatory Relief.

[25] For a discussion of this taxonomy and list of the regulatory programs each category entails, see the 1985 *Regulatory Program of the United States Government*, pp. xiv–xxiii.

[26] Appendix V provides guidelines on how to estimate benefits and costs and how to organize these data and facts to aid the policymakers in their regulatory decisions.

[27] Generally, a major rule is a regulation that is likely to result in (1) an annual effect on the economy of $100 million or more, (2) a major increase in costs or prices, or (3) significant adverse effects on competition, employment, investment, productivity, or innovation.

[28] The 1987 Regulatory Program also discussed nine regulatory impact analyses performed by five agencies. See "The Role of Regulatory Impact Analysis" in the 1987 *Regulatory Program of the United States Government* (pp. xv to xxii).

Finally, OSHA's fall protection standard, issued in 1985 for the construction industry, was supported by benefit-cost analysis using best estimates, proper discounting techniques, and sensitivity analysis that established the economic desirability of the regulation.[30]

> *Regulatory Policy Guideline No. 4:* Regulations that seek to reduce health or safety risks should be based upon scientific risk-assessment procedures, and should address risks that are real and significant rather than hypothetical or remote.

This guideline is, perhaps, the most controversial one of the ten. In fact, some statutes, such as the Delaney Clause of the Food and Drug Act, sharply restrict agencies' ability to consider the magnitude of risks; the Delaney Clause requires that food additives that "induce cancer in man or animal" must be banned without indicating any consideration of remoteness of risk.[31] And until the Supreme Court ruled that before OSHA may issue a rule it must make a determination that a "significant" risk exists and would be substantially reduced by the proposed standard, OSHA declined to estimate the benefits of its proposed health standards, on the grounds that its statutory mandate did not require such considerations.[32]

When agencies do risk assessments or benefit estimates of health and safety regulations, it is frequently the practice to err on the side of caution and overestimate risks by the use of conservative assumptions and risk assessment models.[33] Moreover, since these conservative assumptions are often made by different technicians at different phases of the risk assessment process, the degree of total overestimate or bias is almost never known. Thus the decisionmaker may be left with no way of knowing whether the "risks are real and significant rather than hypothetical and remote." Even though these conservative policies are well-intended, they are likely to be less protective of the public health than policies based on a best estimate of risks. Resources and effort wasted on *de minimis* risks hamper the ability of society to reduce other real and significant risks that would provide even greater safety overall.

In accordance with this second regulatory policy guideline, many of the regulations issued in the last several years have been directed at reducing real and significant risks. Examples include OSHA's 1987 grain-handling regulations aimed at reducing the risk of grain elevator explosions, OSHA regulations that reduce occupational exposure to human carcinogens, such as asbestos and benzene, both issued in 1986, and the 1984 rule issued by the National Highway Traffic Safety Administration (NHTSA) requiring passive restraints and encouraging State seat belt laws.

Despite these successes, statutory prohibitions on risk assessment and some agency policies still lead to wasteful regulatory efforts aimed at speculative and insignificant risks when compared to the greater risks that other substances and activities pose. Control of the latter would provide greater benefits at less cost to society. It is important to improve risk assessment techniques and to assure that, to the extent permitted by law, regulatory decisions take into account real expected risk reductions.

## POLICY GUIDELINES AIMED AT PRODUCING FAIR AND RESPONSIVE GOVERNMENT

Better economic analysis may help focus a regulatory program and help decisionmakers make it more efficient and internally consistent. But taken alone, to make the existing web of regulations more refined and coordinated only means that for each subject area the government will be more effective in regulating. By itself, this means that government controls will become more efficient, and compliance will become more effective, more pervasive, and more overwhelming in controlling the man on the street.

In other words, more and better analysis of the possible effects of a given regulation does not solve the problem of cumulative effects making the public subject to many different kinds of regulations, often unexpectedly, from a varying mix of governmental regulators, whether Federal, State, or local. The man on the street may still feel a sense of frustration or alienation at what he views as his lack of participation in formulating these regulations; in not having them flexible to fit his or her particular circumstances or needs, unanticipated at the time the regulations were formulated; and in not allowing him or her enough individual discretion to meet the widely different circumstances that exist across this large and economically diverse country.

As a result, the Administration has also sought through the review process of Executive Order No. 12291 to address the problems of the cumulative impact of regulations; the varying mixture of Federal, State, and local regulators; and the public sense of alienation and nonparticipation. Through implementation of this Order, the Administration has sought to provide an understandable rationale for government action and, through Executive Order Nos. 12291 and 12498, to better articulate its long-term regulatory goals.

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[29] See EPA, *Costs and Benefits of Reducing Lead in Gasoline: Final Regulatory Impact Analyses* (February 1985).

[30] Preliminary Regulatory Impact and Regulatory Flexibility Assessment of Subpart M—Fall Protection (29 CFR Part 1926.500-.503), OSHA Office of Regulatory Analysis, August 30, 1985.

[31] 21 U.S.C. 376(b)(5) and 21 U.S.C. 348(C)(3)(A).

[32] See the Benzene decision, *Industrial Union Department v. American Petroleum Institute*, 448 U.S. 607 (1980).

[33] This problem is discussed below in greater detail. It was also the subject of a chapter in the 1986 *Regulatory Program of the United States Government*, entitled "Improving Coordination and Consistency in Risk Regulation" (pp. xix to xxvi).

Those Regulatory Policy Guidelines that seek to have the government act in fairer ways can be subgrouped into three categories. Several guidelines help harness market incentives to further social and economic goals. Others seek to have the Federal government reduce regulatory burdens on State and local governments. Still others seek to have regulatory agencies streamline their regulatory procedures.

### Harnessing Market Incentives

Many aspects of a particular regulatory program can benefit from the greater use of incentives based on market performance. Such reliance on market incentives leaves the public freer to undertake its own activities in accord with incentives and constraints similar to its day-to-day activity.

> *Regulatory Policy Guideline No 2.* Regulation of prices and production in competitive markets should be avoided. Entry into private markets should be regulated only where necessary to protect health or safety or to manage public resources efficiently.

This is the regulatory principle that has guided efforts to "deregulate" rate and entry barriers in such industries as airlines, trucking, buses, communications, and finance. Most of the deregulation that has been accomplished in these industries has been accomplished through legislation and the deregulatory initiatives of appointed commissioners responsible for the so-called independent regulatory agencies.

One area in which Executive branch agencies do issue regulations that set prices and output is the labor market. The Fair Labor Standards Act (FLSA) sets minimum wage rates (the "price" of a worker's services) and maximum working hours, and allows the Federal government to issue regulations to help enforce those conditions. One of the first regulatory actions of the Administration was to stay Labor Department regulations issued at the end of 1980 that would have reduced the number of workers that could be employed as managers or professionals, exempt from the minimum wage and overtime provisions of the FLSA. This action opens up opportunities for managerial training jobs and increases competition in these markets.

In addition, the Department of Labor in the past issued regulations that restricted where or how people could work in order to make it easier to enforce the wage and hour laws. Starting in the forties, the Department placed off-limits seven industries for workers who wanted to work at home: knitted outerwear; handkerchiefs; gloves and mittens; embroideries, buttons and buckles; jewelry manufacturing; and women's apparel. In 1984 this Administration issued a final rule lifting the homework ban in knitted outerwear if employers applied for a certificate. In March of 1988 the Administration issued a proposed rule that would lift the ban in the remaining industries, except women's apparel and hazardous jewelry manufacturing operations, which are being addressed separately.

> *Regulatory Policy Guideline No. 3:* Federal regulations should not prescribe uniform quality standards for private goods or services, except where these products are needlessly unsafe or product variations are wasteful, and voluntary private standards have failed to correct the problem.

The private economy produces wide variations in goods and services in response to differences in the preferences of consumers. Standardizing the safety or other quality features of products may, however, be beneficial where products have subtle but important features that are difficult for consumers to assess, as in the case of technically complex products such as drugs and automobiles, and unbranded products such as many agricultural commodities. In these cases standardization reduces information costs. Standardizing the products of different suppliers may also promote economic coordination, as in the case of frequency calibrations on radios and televisions; and automobile bumper heights.

When standardization is good for consumers for safety or other reasons, it will often be good for producers as well, by expanding the markets of individual sellers, minimizing product liability, or for other reasons. That this is so is demonstrated by the fact that the American economy is "regulated" by thousands of safety and other product standards established privately by trade associations and independent standards-setting bodies. These standards do not need to be enforced by a government agency, because sellers have strong private incentives to follow them. Ignoring these standards could leave sellers open to ruinous tort liabilities or to eroding sales because their products are incompatible with other products or with consumers' expectations.

There are circumstances where private markets, standards-setting procedures, and liability law may fail to provide products and services that are in the best interest of consumers. When the health effects of products become apparent only over long periods of time and when causality from the product of a given producer is difficult to determine, product quality standards may be needed. This does not mean, however, that regulatory agencies should impose product standards whenever any degree of health, safety, or economic risk has been identified, for some degree of risk is a feature of virtually all goods and services. Rather the test should be whether existing levels of product quality are needlessly risky or wasteful from the consumer's point of view and whether private incentives for adopting product standards are for some reason inadequate.

The Administration has revised uniform quality standards in several areas to the benefit of consumers and producers alike. Examples include: the deregulation at the Federal level of minimum property standards for housing, leaving this matter to be determined by State and local codes; the relaxation of energy standards for buildings and automobiles after energy prices were deregulated so that consumers could determine whether to pay for energy use in capital costs or in operating costs; and the relaxation of automobile bumper standards so that consumers could choose the type of bumper most suited to their own driving style and financial profiles, that is, by choosing between a more easily damaged but less expensive bumper and a less easily damaged but more expensive bumper.

> *Regulatory Policy Guideline No. 5:* Health, safety, and environmental regulations should address ends rather than means.

Regulations that impose precise engineering requirements are generally cost-ineffective, especially when applied on a uniform nationwide basis. The best means of accomplishing a given environmental end varies from firm to firm, region to region, and over time. Imposing engineering uniformity on these natural variations almost always results in more economic cost than necessary to achieve a given environmental benefit, or too little environmental benefit for a given economic cost. Moreover, government-prescribed uniform technology retards productivity growth, dampening market competition and reducing incentives for innovation in both production and pollution-control markets.

For these reasons, regulatory standards should be adopted in terms of results or performance rather than specifying the means employed to achieve the results. With performance-oriented standards, regulated firms are responsible for meeting a prescribed regulatory target, but are free to choose or invent the easiest or most cost-effective methods to reach the target.

In practice, the distinction between performance standards and design standards is a continuum rather than a simple dichotomy. Regulatory policy-making usually involves selecting a point on a spectrum running from pure design standards to pure performance standards. The variety of approaches to protecting workers from airborne health hazards is a typical example. There is a spectrum of choices theoretically available in defining a standard, ranging from a design standard to an exposure standard to a health standard, the ultimate objective.

While moving toward the performance end of the spectrum produces more cost-effective regulations, this tendency is offset by difficulties of enforcing performance standards in certain circumstances. A pure health standard would be impractical, for example, where the disease being protected against manifests itself only after decades of exposure. Uncertain causation between a given design and a given performance objective is not, however, an argument against performance standards, since this uncertainty also applies to any design requirement prescribed by the government. To the degree that performance can be measured or reasonably imputed, a standard based on this level of performance is always superior to more means-oriented regulation.

Examples of standards more at the performance end of the spectrum than the design end include: OSHA's hearing conservation standard issued in 1983 that uses temporary shifts in hearing loss to trigger hearing protectors, FDA's "tamper-resistant packaging" regulation, and OSHA's grain-handling regulations that allows firms several options for reducing the risks of grain dust explosions.

A step beyond performance standards is structuring regulations to provide individuals with information on health benefits and risks, so they can make their own judgments—this shifts discretion concerning exposure to the risk back to the individuals involved. For example, in June of 1987 the Food and Drug Administration issued a final regulation that permits individuals with serious or life-threatening illness access to experimental drugs. Prior to issuance of this rule, only individuals participating in clinical trials, with few exceptions, had access to these drugs. Now as soon as very early test results demonstrate safety and there is at least some indication of effectiveness, drug manufacturers are able to apply for "treatment use" of experimental drugs, and consumers on advice of their doctors can make the decision for themselves.

In the same vein in August 1987 the Food and Drug Administration published a proposal to modify its policy on health claims on food labels. In the past, health claims have been prohibited on labels. FDA's proposal would permit health claims on food labels if they are truthful, non-misleading, and adequately supported by scientific evidence. Making this information available to consumers will allow consumers access to educational information and will permit consumers to make better informed judgments about the products they purchase and consume.

> *Regulatory Policy Guideline No. 8:* Where regulations create private rights or obligations, unrestricted exchange of these rights or obligations should be encouraged.

Regulatory policies frequently create rights or obligations with substantial value in private markets.[34] A license to use a certain portion of the broadcast frequency spectrum, a permit to land at a certain airport, and a permit to explore for oil on a certain tract of the outer continental shelf are valuable rights secured through regulation. In the same way, requirements to limit pollution from certain kinds of products or production facilities are costly obligations imposed through regulation.

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[34] For a fuller description of the Administration's program to promote the trading of rights and obligations created by regulatory actions see the chapter in the 1986 *Regulatory Program of the United States Government*, entitled, "Efficient Allocation of Regulatory Rights and Resources" (pp. xxvi to xxxi).

Perfect regulation would allocate such rights and obligations precisely to those firms and individuals who could use or meet them to produce the greatest benefits to society as a whole. But regulation is never perfect and rarely as good as private markets in allocating rights and obligations.

Frequently private exchange of regulatory rights and obligations occurs so naturally that it does not require a formal policy of encouragement at all. Drug companies have the unquestioned right to sell licenses to produce and market drugs approved for marketing by the FDA. When a manufacturing plant is purchased, so is the obligation to continue meeting OSHA health and safety standards (which reduces the plant's price by the cost of meeting these standards).

In other cases marketing rights have been uncertain without the blessing of the regulatory agency itself. In the early years of the FCC, there was doubt whether broadcasting licenses could change hands privately when stations were sold; the issue has long since been resolved in favor of free exchange with minimal FCC review. The marketability of airport landing "slots" was a contentious issue in the airline industry after the 1981 air traffic controllers' strike limited control capacity at several major airports. Free trading of slots was permitted for the first time in 1982, easing shortages in both large cities and small communities by allocating these scarce rights to their most highly valued uses.

One of the Administration's most promising innovations has been the encouragement of emissions trading. Emissions trading encompasses several methods of improving the cost-effectiveness of stationary-source air regulation. Common to these methods is use of the "bubble" concept, by which total emissions from one or more facilities are considered to emerge from a giant bubble surrounding the facility, allowing companies to control more than required at stacks where costs are low in exchange for less control where costs are high. Under the bubble, compliance can often be accomplished more efficiently than by use of uniform stack-by-stack controls. This is because inexpensive extra controls at one stack can be used to meet more expensive control obligations at another.

Bubbles also have potential to encourage innovative emission control approaches, reach small or dispersed sources that would be difficult to control directly, and secure more reliable, less-polluting production changes that the Environmental Protection Agency (EPA) cannot mandate. Individual bubbles can elicit information needed for better air-quality planning, speed compliance, and strengthen enforcement. They can also provide financial reasons for companies to seek innovative control strategies which surpass requirements at some of their sources, instead of planning merely to meet those requirements through traditional means.

EPA's 1986 Final Emissions Trading Policy replaced an original Bubble Policy issued in 1979 and an Interim Emissions Trading Policy published in 1982. It reflects over seven years' experience with bubbles, and many differing views within and outside the Agency. It provides the framework for review and approval of environmentally sound bubbles and related actions by EPA or States under the Clean Air Act. By clearly defining approval requirements, the Policy will allow States and industry to implement bubbles with greater confidence and predictability. Similar incentive-based approaches are now being implemented or explored by the EPA in several other areas of air, water, and waste pollution control.

### Reducing Burdens on State and Local Governments

A second category in which several of the guidelines can be grouped involves reducing regulatory burdens on State and local governments. Federal grants to State and local governments always come with strings intended to ensure that Federal funds are not misspent. In recent years these strings have often grown into a tight web of restrictions that have hampered local efficiency and accountability, increased program costs, and hurt the individuals the programs were intended to serve. Following President Reagan's deep commitment to restoring a proper balance to our Federal system, the Administration has focused particular attention on freeing States and localities from burdensome and unnecessary Federal regulations.

> *Regulatory Policy Guideline No. 9.* Federal regulations should not preempt State laws or regulations, except to guarantee rights of national citizenship or to avoid significant burdens on interstate commerce.

This guideline supports the President's policy of restoring the principle of "Federalism" to American government. The economic efficiency basis for Federalism rests on the general superiority of decentralized decisionmaking for a complex economic system. These advantages apply with particular force to regulatory decisions.

First, local regulations are more apt to be responsive to local circumstances. The costs and benefits of regulatory policies often vary substantially from place to place, depending on local preferences, geography, climate, population density and demography, economic conditions, and much else. National regulations that seek "average" solutions will typically be overly broad or lenient in some places and too narrow or strict in others.

Second, local regulations afford citizens a greater degree of choice among divergent public policies. One

State can promote temperance, another gambling; one State can encourage tourism, while another welcomes heavy industry.

Third, local regulations allow for diversity and experimentation. The actual effects of regulatory policies are frequently a matter of uncertainty and controversy, and often the best way to assess actual effects is to compare the experience of different States. While local regulations permit the States to learn from one another's successes and failures, national regulations suppress this information.

These considerations suggest that the Federal government should defer to State and local governments, except where rights of national citizenship (such as legal equality among the races) or significant burdens on interstate commerce are involved. The control of surface mining and local air pollution problems, for example, are more appropriate to the States than to the Federal government; the Interior Department and EPA have been "defederalizing" these aspects of their regulatory programs. On the other hand, regulating the safety characteristics of motor vehicles in general is appropriate to the Federal government, since the products being regulated are usually marketed on a nationwide basis, the benefits of multiple approaches to the safe design of motor vehicles are probably small, and a number of widely differing State standards could impose large costs on interstate commerce without being justified by local needs or considerations.

It is not a sufficient case for Federal regulation that the object of regulation is part of interstate commerce. All interstate businesses comply with an array of differing State corporation and securities laws, workers compensation programs, local zoning ordinances, and so forth. As the widespread adoption of the Uniform Commercial Code and other uniform state laws illustrates, States often have strong incentives to standardize their laws when doing so will significantly promote interstate commerce.

Whether something *could* be regulated by the Federal government under the Constitution is a different matter than whether the Federal government *should* step in. The policy question is whether the burdens on interstate commerce arising from divergent State and local regulations are so great that they outweigh the advantages of diversity and local political choice. At the same time, Federal regulation may be justified, even when the object of regulation is exclusively local, if the benefits of regulation are primarily local but the costs fall disproportionately on citizens of other States. In such cases States have incentives to be too restrictive; common examples are State restrictions on nuclear waste disposal facilities, and truck sizes on interstate highways that connect out-of-state markets.

One major success in this area has been the Department of Housing and Urban Development's (HUD's) shift in 1985 from requiring that all federally insured single and multifamily dwellings meet federally prescribed minimum property standards to reliance on existing State or local building codes. In the past builders had to meet the more stringent of the local or Federal codes, codes that sometimes were in conflict. Considerable cost savings and homes built more in line with local conditions and preferences should result.

In another major step the Administration has returned to the States primary authority to allocate water resources. In reversing a 1979 legal opinion on so-called "nonreserved" Federal water rights, this Administration reaffirmed that, unless otherwise directed by Congress, the individual States shall govern how Department of the Interior agencies acquire new water sources. This new policy protects the States' historic rights to determine water allocation.

> *Regulatory Policy Guideline No. 10.* Regulations establishing terms or conditions of Federal grants, contracts, or financial assistance should be limited to the minimum necessary to achieving the purposes for which the funds were authorized and appropriated.

Agencies that administer Federal transfer payments face a temptation to add conditions in pursuit of statutory and nonstatutory goals that are not germane to the purpose for which the funds were authorized and appropriated. Sometimes these conditions find their way into law, such as the air quality attainment conditions on Federal transportation funds. This kind of linkage between two programs is generally a poor way to manage either of them. Irrelevant conditions on transportation grants can only diminish their usefulness. It makes no environmental sense to make the enforcement of air-quality goals more or less strict depending on a State's need for transportation funds.

Too often Federal transfer payments are restricted with so many strings or such detailed reporting and recordkeeping requirements that the usefulness of the payment to the recipient or to the Federal taxpayer nearly vanishes. Obviously some controls are needed to prevent abuse and to ensure that funds appropriated to achieve a specific purpose are channeled efficiently toward that end. But beyond these basic requirements, the transfer of Federal funds should be accompanied by the delegation of maximum discretion in their use. This is particularly the case when the recipient is a State government. Federal grants to States should continue to be shifted more toward block grants, revenue sharing, and transfers of revenue sources.

The Administration has been quite successful in reducing both the red tape and the restrictions placed on funds granted to States and localities in almost every area. Categorical grant programs have been shifted to block grant programs in the Departments of Health and Human Services (HHS), Housing and Urban Development (HUD), and Education (DEd).

The Department of Labor has also reduced the inflationary wage restrictions placed on the use of Federal funds (including funds provided to States and localities) for construction and services. The Davis-Bacon Act and Service Contract Act were passed to assure that the Federal government paid prevailing wages. Overtime restrictions were built in that tended to push wages above what the private sector was paying for similar work. The regulatory changes enacted to date attempt to restore "prevailing" wage to its original meaning of "market wage."

The Executive branch has also worked closely with States to establish more flexible, less burdensome Federal assistance mechanisms. Earlier in this Administration, for example, a joint State and Federal task force worked out a set of cash management policies and practices to govern the exchange of funds between the State and Federal governments. This agreement was formalized in a July 1983 Memorandum of Understanding. In 1984, four States piloted a new reciprocal interest funding technique that was found to be a viable alternative to existing techniques. Moreover, this alternative had sufficient flexibility to fit easily into the States' existing systems. Regulatory language to implement the interest-remitted option is now in place and allows States to select from a variety of cash management techniques.

### Streamlining Regulatory Procedures

The third category under which the regulatory policy guidelines can be grouped addresses ways in which Federal regulatory agencies can streamline this regulatory process. Environmental and public protection statutes frequently require members of the public to obtain government permits or approvals before undertaking certain activities. When the approval process becomes lengthy, uncertain, and bureaucratic, the result can be costly delays in the introduction of beneficial new products or the commencement of important development projects. This Administration has placed heavy emphasis on making Federal permitting programs more prompt, predictable, and efficient.

> *Regulatory Policy Guideline No. 6.* Licensing and permitting decisions and review of new products should be made swiftly and should be based on standards that are clearly defined in advance.

Regulatory programs requiring review or approval of new products and new production facilities have expanded manyfold in recent years. New drugs, new medical devices, and new food additives require approval of the Food and Drug Administration. New pesticides and new chemicals must be reviewed by the Environmental Protection Agency. New powerplants and transmission lines, factories, pipelines, ports, and other major construction projects may need Federal approval for air and water discharges, rights-of-way, or effects on navigable waters, in addition to a long list of State and local approvals. Virtually any economic activity on the vast Federal landholding (including the outer continental shelf as well as most of the land in the Western States) requires the approval of the managing Federal agency. A facility that crosses several jurisdictions, such as an interstate oil pipeline, requires multiple government permits.

On top of the system of Federal permits is an additional layer of "cross-cutting" requirements. According to the nature of the project, the issuance of even a narrow Federal permit may trigger additional requirements for environmental impact assessment, archeological and historic preservation review, endangered species protection, coastal zone management planning, and other requirements.

While these permitting systems have doubtless reduced the chance that a needlessly unsafe product will be introduced or an excessively obnoxious facility be built, it has also increased the likelihood of the opposite error: that a worthwhile product or facility will not be approved. One reason is simply inevitable errors of judgment. But the problem runs much deeper than this, for regulatory agencies face systematic incentives to err on the side of caution and delay. An agency charged with assuring that all new products are safe is likely to be excessively cautious in granting approval. It will get none of the credit for good products but a large share of the blame for bad ones, and there is bound to be substantial uncertainty about which is which before a given product is actually marketed.

To the regulator the hazards of an erroneous approval seem far more immediate than the hazards of depriving the public of a new drug or chemical or factory that could be better than the old. And representatives of the old products and facilities that would have to compete with the new ones will supply the regulator with reasons aplenty why the new ones would probably not be any better after all. So there is a natural bias to disapprove or, more often, to delay a decision pending receipt of more information.

The challenge is to speed up the various permitting processes without materially increasing the risk of erroneous judgments. The Administration has had some success in this. One major success in this area is the approval process for new drugs. The Food and Drug Administration has instituted reforms and procedures to speed up the investigation and application process for new drugs, especially where they might be useful in the treatment of patients in serious or lifethreatening situations. The Environmental Protection Agency adopted several exemptions from its "premanufacture review" requirements for new chemicals, eliminating or reducing requirements for types of chemicals that pose no environmental risk, and streamlined its permitting requirements under its air and water quality programs. The Army Corps of Engineers streamlined its process for issuing permits for discharge of sludge and fill material into U.S. waters, cutting the average processing time in half.

*Regulatory Policy Guideline No. 7.* Qualifications for receiving government licenses should be the minimum necessary. Where there are more qualified applicants than available licenses, the licenses should be allocated by auction or random lottery rather than by administrative procedures.

Many regulatory programs, often operated by independent commissions, license entry into particular markets. Licensing may also be used to promote health or safety or simply to manage the use of scarce resources controlled by the government. In the case of licensing to promote health and safety the qualifications of individual applicants are important to the regulatory program, but in the case of simply allocating scarce resources they are not. Approving new drugs for safety and new pesticides for environmental effects requires careful case-by-case review to determine the qualifications of applicants. On the other hand, because licensing Federal land for grazing does not require government appraisal of the personal characteristics of individual ranchers, case-by-case review is not needed. Sometimes both kinds of licensing take place in the same agency. The Federal Aviation Administration must assure that commercial airlines and airline pilots meet demanding safety qualifications. But when the FAA allocates scarce airspace around congested airports, it need not decide which airlines use the available slots safely, because airlines have already been certified as to safety. Therefore, the market should be allowed to allocate the slots according to economic efficiency.

Where licensing is undertaken simply to allocate government-controlled resources, there is no need at all for quality standards, case-by-case reviews, or administrative proceedings. Direct use of the price system, through auctioning licenses or charging fees, is all that is necessary to allocate the resources to those who can use them most productively. Where auctions or fees are prohibited by statute, random lotteries at least avoid the costs and potential abuses of allocating rights by administrative procedures. When combined with the private marketing of rights, lotteries also ensure that the resources in question are put to their most valuable economic use.

Regulatory agencies on occasion have confused licensing to allocate resources with licensing to protect consumers or the environment. A virtue of auctions, fees, and lotteries over administrative allocation is that they force a clear distinction between the two purposes, and prevent inappropriate expansion of the government's regulatory powers through vague and subjective licensing standards. For example, the original legislative purpose of radio and television licensing was to promote efficient use of the electromagnetic frequency spectrum. The Federal Communications Commission's licensing procedures were long used, however, to scrutinize in detail the quality of individual applicants and the past performance of renewals. This is not only unnecessary to efficient spectrum management but has raised serious problems under the nation's primary deregulation policy, the First Amendment. With the emergence of new communications technologies competitive with broadcasting, the FCC has cut back substantially on the administrative procedures required to obtain or renew various broadcast licenses.

In the transportation area, both the Interstate Commerce Commission and the Civil Aeronautics Board granted route approvals between city-pairs on a "need" basis, which often worked to the detriment of new firms seeking entrance and to the benefit of firms with existing approvals. The reforms of the ICC and airline deregulation have allowed competition to blossom between numerous city-pairs in both the trucking and airline industries, dramatically expanding service and lowering costs for consumers overall.

## SUMMARY

The President's regulatory principles and the guidelines supporting them represent the infusion not only of economics into the rulemaking process but also of better government management; of proper allocation of regulatory activity between the Federal, State, and local governments, and the free market itself; and of ultimate fairness to those benefitted and regulated. The initial inquiry under the President's regulatory principles is always whether Federal intervention is needed: why the problem a regulation would address is not adequately addressed by private markets, or State or local authorities; and whether the regulation would actually improve upon the functions of the market and existing State and local programs.

But in all cases, the "bottom line" of the regulatory principles stated in Executive Order No. 12291 is whether a proposed regulation will benefit society as a whole. To accomplish this goal, agencies need to have considered all the available evidence of the rule's likely consequences—whether these consequences are issues of economic impact, fair management; or of appropriate allocation of authority and responsibility to the Federal, State, or local governments, and particularly to individuals operating in an open marketplace and a free society.

# *MAKING FEDERALISM WORK*

Since the beginning of this Administration, Federalism has been a key theme in Federal policymaking. As President Reagan observed in January 1988:

> When our Administration came to office, we took it as one of our chief aims to reawaken the Federalist impulse and approach the Constitution with a new fidelity—in short, to restore power to the States. By now you should know how, since 1981, we've worked to widen the scope for independent State decisionmaking. I'm proud to say that our Federalism focus is continuing.*

Although this "Federalist impulse" has been evident for the last seven years and has been discussed in previous Regulatory Programs, at no time has it been stronger than during the past year. This chapter describes the efforts undertaken by this Administration since the last Regulatory Program to make Federalism work. These actions include:

1. adhering to Federalism principles in Executive branch;
2. implementing State and local recommendations for more efficient government; and
3. establishing new mechanisms for ensuring that the Federal government regulates State and local concerns only when there is specific authority and genuine need for Federal intervention.

## FEDERALISM IN FEDERAL RULEMAKING

The Federal government issues thousands of regulations every year, touching on almost every aspect of American life. Just as they affect individuals and businesses, many of these rules directly affect the ways that State and local governments govern. This Administration has long recognized, however, the constitutional and administrative boundaries on Federal action, the time-proven effectiveness of State and local administration of Federal programs, and the importance of building into Federal rulemaking maximum administrative flexibility for State and local governments.

The Executive branch has undertaken over the past year and plans to initiate this year several particularly significant Federal regulatory activities affecting States and localities. Many of these rulemakings might be considered "deregulatory" from a Federal perspective. But whether they provide administrative flexibility, promote efficiency, decentralize the decisonmaking process, or simply incorporate the views of State and local governments in Federal rulemaking, each embodies a respect for the authorities and capabilities of the non-Federal levels of government.

### Providing Administrative Flexibility

States and localities are partners with the national government in providing services to the American people. And as such partners, States and localities must be provided with the flexibility they need in order to serve best their citizens. Consistent with that philosophy, the Department of Health and Human Services (HHS) has taken major regulatory actions over the past year to enhance the ability of State and local governments to control federally funded assistance programs. Two examples of such action involve increased State flexibility in paying for prescription drugs under the Medicaid program, and reducing complexity and delay in acquiring computers and computer-related equipment in the Aid to Families with Dependent Children (AFDC) program.

HHS issued regulations in July 1987 that transferred to the States more discretion and flexibility in the actual design and administration of a payment system for prescription drugs under the Medicaid program. Under these new rules the Federal role is limited to oversight and accountability only to the extent necessary to establish upper limits on State expenditures for prescription drugs that may be eligible for Federal matching. Prior to these rules the Federal government set national payment limits for drugs on a prescription-by-prescription basis for state Medicaid agencies. The rules are cost-effective, with anticipated savings of as much as $100 millon a year in Federal funding and $60 million a year to the States.

In September 1987 HHS issued proposed rules designed to improve the system of review and approval of general plans and specific requests for the purchase of computers and computer-related equipment for the AFDC program. Under the existing rules States were required to submit advance planning documents for Federal review prior to engaging in automatic data processing (ADP) acquisition. They were also required to submit requests for proposals (RFPs), contracts, and contract amendments for Federal review and approval even after the advance planning documents had been approved.

States complained that this process placed the Federal government in the position of too closely monitoring State actions, and it imposed paperwork requirements that resulted in unnecessary and unwarranted delays in computer acquisition. In the end, States asserted, the AFDC program was suffering because of such delays. Although some level of Federal scrutiny is appropriate in this area due to past State systems failures, HHS agreed that the existing system is too cumbersome. The proposed rules issued in 1987 were designed to require more "up front" planning by the States but reduce many of the existing prior approval requirements. When finally promulgated, the new rule should more properly balance State accountability and State flexibility.

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* Remarks to the National Conference of State Legislators at a White House Briefing on the Administration's Domestic Agenda, January 29, 1988.

The Department of Housing and Urban Development (HUD) also has several policy initiatives designed to provide maximum feasible local control in the implementation of Federal assistance programs. HUD's Office of Public and Indian Housing, for example, has undertaken a decontrol initiative to give public housing agencies (PHAs) and Indian Housing Authorities (IHAs) maximum authority and responsibility for the management of their local programs. Decontrol is a continuing regulatory relief effort that HUD intends to expand to additional areas for PHAs and IHAs with good performance records.

HUD's pending rules on Lease-Grievance Procedures similarly provide for more local flexibility for PHAs, and will place increased reliance on State-administered landlord-tenant laws. In addition a number of new programs or program amendments in the Housing and Community Development Act of 1987 (Public Law 100-242) will afford opportunities to the Department to further the principles of Federalism. For example, the revised funding methods in the Comprehensive Improvement Assistance Program (CIAP) (Section 119 of the Act) require the Department to develop an equitable formula for allocating CIAP funds according to HUD's assessment of modernization needs. In addition, implementation of the new law will increase local choice of improvement projects and will lead to greater local control.

In the same vein the Department of Energy (DOE) initiated several regulatory actions in 1987 to enhance the ability of State and local governments to administer federally funded assistance programs. For example, DOE has proposed easing some of the restrictions on expenditures under the State Energy Conservation Program. The major impact of this regulatory change would be to allow States greater discretion in spending oil overcharge monies on capital equipment. Furthermore, because of changes to the Residential Conservation Service required by the Conservation Service Reform Act of 1986, DOE initiated a rulemaking allowing States to assume the lead role in the processing of applications for utility waivers from the provisions of existing State plans.

The Department of Agriculture (USDA) has also attempted to provide more administrative flexibility in its program rules for State agencies. For the past few years, for example, the Farmers Home Administration (FmHA) has intensified its efforts to utilize and involve the private sector as a source of agricultural credit. FmHA developed a program called "Operation Assist" to emphasize the Administration's efforts to shift from direct government lending to private sources of lending with a government guarantee. FmHA field personnel assist eligible borrowers to obtain private credit through local lending institutions by introducing the applicant to the lender and providing the necessary paperwork to enable the lender to determine if the institution would consider the applicant for a FmHA guaranteed loan.

The Administration's efforts to shift from insured to guaranteed lending has significantly increased the private sector's involvement as a source of agricultural credit at fair and competitive rates.

### Promoting Efficiency Through Governmentwide Common Rulemaking

States have long complained about inconsistent Federal requirements for grants and other assistance programs. They point to Federal departments and agencies with significantly different and sometimes inconsistent administrative requirements for similar grants and programs. They perceive these inconsistencies as one of the biggest obstacles to efficient administration of Federally assisted grants and programs.

Recognizing this problem, in 1987 the President directed all Federal grant-making agencies to propose simultaneously and subsequently adopt verbatim a single, governmentwide grants management common rule. This common rule replaced agency implementation of Office of Management and Budget (OMB) circular No. A-102, "Uniform Administrative Requirements for Grants and Cooperative Agreements with State and Local Governments." Although the circular was considered at the time of its adoption in 1971 a breakthrough in the simplification of grants management, the President noted that "after 16 years, some of the provisions are out of date, there are gaps where the standards do not cover important areas, and agencies have interpreted the circular in numerous different ways in their regulations."

Consequently, the President requested agencies to propose a common rule within 90 days and issue a final rule within one year. On March 11, 1988, the agencies completed their assignment by issuing the final rule, which becomes effective for grants awarded on or after October 1, 1988. The common rule eliminated redundant and inconsistent administrative requirements among and within the 24 Federal grant-making agencies. It rescinded all inconsistent grants administration provisions in program regulations, and its provisions supersede (unless otherwise mandated by statute or approved by OMB) all similar provisions of noncodified program manuals, handbooks, and other materials.

The single, governmentwide grants management common rule also contains numerous policy changes to further Federalism, regulatory relief, and business-like management of grants. Two particularly significant Federalism changes affect States.

First, States no longer must follow uniform Federal standards or requirements for financial management systems, equipment, or procurement. Instead States will expend and account for grant funds according to their own State laws and procedures. Second, in state-administered programs (other than the open-ended entitlement programs), States no longer have to apply uniform Federal administrative standards to subgrantees. Instead States are free to condition and manage funds which flow down to subgrantees according to their own State laws and procedures.

Recently several States and State organizations, including the National Governors' Association (NGA) and the National Association of State Budget Officers (NASBO), have proposed revision and simplification of Circular No. A-87, "Cost Principles for State and Local Governments." This Circular, first issued in the late 1960s, provides uniform rules applicable to about $115 billion in grants and contracts to State and local governments. It defines allowable costs for Federal assistance programs and sets forth the procedures to recover them. OMB is currently working with these organizations to explore proposed changes.

Although OMB hopes to provide more flexibility for State procedures through these revisions, it must also preserve accountability for Federal funds. The Office of the Inspector General (OIG) at the Department of Health and Human Services recently conducted a comprehensive review of the implementation of the Circular by State and local governments. The auditors examined the methods used by State and local governments in allocating administrative cost to Federal programs, as well as methods used to determine the allowability of cost. The OIG audit identified significant problems with some State operations that must also be addressed during the review of the Circular. OMB looks forward to working with State representatives to address these problems. OMB plans to issue the draft revisions to Circular No. A-87 for comment in the summer of 1988.

### Cutting Federal Red Tape

Sometimes the best way the Federal government can help States is simply to pare down onerous administrative requirements. Just as with any business person or individual, Federal paperwork or other administrative requirements are burdensome and costly to State and local administrators.

The Department of Transportation's Federal Highway Administration (FHWA) has been particularly sensitive to the problem of excessive Federal red tape and has taken steps to alleviate it. Over the past several years FHWA has issued amendments to various environmental impact regulations prescribing policies and procedures for preparing environmental documents pursuant to the National Environmental Policy Act (NEPA), and evaluations of project proposals that would use land from public parks, recreation areas, refuges, and historic sites pursuant to Section 4(f)of the Department of Transportation Act of 1966. These policies and procedures were first issued in 1971 and have been revised several times.

The last revisions, issued on August 28, 1987, relieved significant administrative burdens on States in a number of ways, including: (1) streamlining the project-development process and providing increased decision-making authority to agency field offices; (2) eliminating duplication in FHWA's public involvement regulations; (3) contributing to the establishment of a one-stop environmental impact process in which public involvement is fully integrated with other project development and environmental procedures; (4) clarifying the conditions under which a supplemental environmental impact statement is required; (5) eliminating the need for FHWA and state highway agencies to prepare environmental assessments and findings of no significant impacts for over 300 projects per year nationwide. In the future, these types of projects will be processed as categorical exclusions. The revised rule will avoid the need to prepare reports for these projects, estimated to cost $40,000 each, and will save at least six months in processing time.

### Decentralizing the Decisionmaking Process

Government works best when decisionmaking responsibilities are placed at the lowest possible level. Important decisions affecting people should be made by those closest to the problem. Moreover, responsiveness to local preferences and conditions is best assured by providing local institutions with authority and responsibility for action. Over the past year Executive departments and agencies have initiated or completed several rulemakings intended to decentralize decisionmaking in Federal programs.

Recent regulations issued by the Department of the Interior implementing provisions of the 1977 Surface Mining Control and Reclamation Act (SMCRA) provide a good example of this decentralization effort. The Act has a vigorous Federalism focus and clearly intends that the States have primary responsibility for assuring that the objectives of the Act are met in a manner that is responsive to local conditions. SMCRA encourages States to develop regulatory programs for surface coal mining and reclamation operations and coal exploration operations so that they can assume regulatory responsiblity from the Federal government. Once states have developed such programs and demonstrated that they can adequately implement those programs, they may assume regulatory responsibility (primacy) over both initial and permanent surface coal mining and reclamation operations as well as coal exploration operations.

One of Interior's current rulemaking efforts underscores the Administration's commitment to primacy: the proposed Evaluation of State Responses to Ten-Day Notice Rule, issued on September 9, 1987 (52 FR 34050). SMCRA provides that OSMRE will not inspect a mine site in a State awarded primacy where it has information that a possible violation of the regulatory program exists, absent an imminent danger to persons or property, or imminent harm to the environment, without giving the State ten days' notice of its intention to inspect. The State must also be allowed to take appropriate action to correct the possible violation or to show good cause for not correcting it. The Ten-Day Notice Rule will define "appropriate action" and "good cause" for the first time. Definition of those terms will enhance primacy and support Federalism by outlining the conditions under which a State's response to a ten-day notice is acceptable, thereby obviating the need for Federal inspection of the operation. Under the rule OSMRE will accept any State response to a ten-day notice that is not arbitrary, capricious, or an abuse of discretion under the State program. The rule also gives examples of good cause. In addition the rule establishes an appeals procedure for States wishing to challenge an OSMRE decision to authorize a Federal inspection.

In a similar decentralization effort the Department of the Interior's National Park Service has taken steps to shift a greater number of decision-making responsibilities and capabilities for historic preservation to the State Historic Preservation Offices. Each State Historic Preservation Office (SHPO) functions as the agent of the National Park Service in administering the historic preservation programs within the State. The National Historic Preservation Act, as amended, provides SHPOs with overall direction and policy for the State Historic Preservation Programs, and the operating program instructions contained in the Historic Preservation Fund Program Manual provides guidance for program management.

By implementing the State Program Review Process, the National Park Service has begun to shift its responsibilities for overview and monitoring of the State historic preservation programs in the direction of management by exception with the SHPOs rather than on a project-by-project basis. Using the on-site programmatic audit as the major mechanism for monitoring and reviewing State compliance with Federal requirements, the Service has greatly reduced the necessity for individual project-by-project review work. This will eventually reduce the number and frequency of requests that States will have to submit for review and approval. It will also enable the Service to concentrate on programwide needs, such as consistency of program operations among and between States, and on providing hands-on technical assistance in program development and execution.

### Benefiting from State Views in the Development of Federal Rules

Federalism depends on promoting an active and open dialogue between the Federal government and its State and local partners. To that end in 1985 the Environmental Protection Agency (EPA) established the State/EPA Committee, composed of 17 State members. The Committee, which meets quarterly, provides EPA with consultation and advice on EPA operational issues.

In addition EPA has found that regulatory negotiation offers a valuable forum for consulting with State and local officials. Between three and six State and local representatives have participated in each of EPA's seven negotiations to date. Like the other participants in a regulatory negotiation, State and local interests are a party to the consensus on which EPA bases its proposed rule. Their participation in a negotiation is especially important, because EPA relies on State and local agencies to implement many regulatory programs. Three recent negotiations illustrate how the negotiation process can allow EPA and other parties to draw constructively upon State and local experience and design rules that are more responsive to State and local concerns.

In the Asbestos-in-School negotiations, for example, the negotiating committee included representatives of local school districts, State educational agencies, and State health agencies. The parties agreed that EPA's proposed rule allowed flexibility for local authorities to determine what response actions were necessary where asbestos was found. Based on the negotiating committee's recommendations, EPA has allowed, as described in its proposed rule, issued April 30, 1987 (52 Federal Register 15833), "discretion within a range of acceptable response action alternatives, given the condition of the material, local circumstances, technological feasibility of response actions, economic considerations, and other relevant factors."

In the negotiations on proposed Emission Standards for Woodburning Stoves, the process allowed EPA and the other parties on the negotiating committee to consult directly with representatives of two States with experience in regulating woodstove emissions, as well as two other States that were considering standards for woodstoves. The Oregon and Colorado representatives provided data and a perspective that the full committee was able to draw on during the negotiations.

Similarly in developing rules restricting underground injection of hazardous wastes, the negotiating committee benefited from the participation of officials from three State agencies. Together these three agencies represented a range of views on underground injection. The participants agreed that the State officials' contributions led to a proposed rule that was more compatible with State programs and practices than the conventional rulemaking process might have produced.

Examples of a consultative process between States and the Federal government can also be found in rulemaking by the Federal Emergency Management Agency (FEMA). As part of its 1987 Regulatory Program FEMA developed criteria for earthquake hazards reduction assistance to State and local governments. These criteria were developed in close coordination with State and local representatives.

In July 1986 FEMA sent a policy paper describing the substance of and intent behind major provisions of a possible proposed rule to its regional offices. FEMA instructed these offices to circulate the paper to the states for comment. The agency considered the State comments over the next year as it drafted the regulation.

FEMA published the proposed rule on July 6, 1987. As a result of comments on the proposal, most of which came from States, FEMA made significant changes in the final rule, published September 8, 1987. The most significant of these changes was to delay State cost sharing requirements until fiscal year 1989 to accommodate State legislative and budget cycles and constraints. As a result of additional comments and discussions with State officia's FEMA made other changes to the final rule as well as to the formula developed by the agency to apportion earthquake program funds among eligible States. In addition FEMA intends to make adjustments to the "formula factors" for the FY 1989 allocations, and plans to consult with the affected States during this effort.

## LISTENING TO THE STATES: RECOMMENDATIONS FROM THE NATIONAL GOVERNORS' ASSOCIATION

Much of the Administration's recent success in making Federalism work is due to the interest and efforts of State and local governments. The most clear example of this was the National Governors' Association's (NGA's) Federal Assistance Review Project. On February 21, 1988, Office of Management and Budget (OMB) Director James C. Miller III presented the NGA with a final report on the Administration's implementation of 47 NGA recommendations for alleviating federally imposed administrative burdens.

This project began 16 months earlier when in October 1986 Governor John Sununu of New Hampshire, then Chairman of the NGA's Federal Assistance Review Project, wrote to the President with recommendations for improving the administration of Federal assistance programs. These recommendations, collected from 26 States and national organizations, affected 19 Executive branch departments and agencies.

Pursuant to a subsequent meeting between Governor Sununu and the President, the White House Office of Intergovernmental Affairs and OMB, in cooperation with the affected departments and agencies, undertook an extensive review of all the NGA recommendations. During this review OMB and agency officials frequently contacted NGA staff and State officials for additional information or to discuss possible solutions to the issues raised.

On June 29, 1987, President Reagan, Vice President Bush, and OMB Director Miller met with Governor Sununu and Governor George Sinner of North Dakota. The President presented the Governors with an interim report describing progress in the Administration's review of the NGA's recommendations. During the meeting the President reiterated his Administration's commitment to reducing Federal regulatory and paperwork burdens. He expressed his hope that all Governors would continue to point out instances when the Federal government's actions interfere with the States' abilities to govern effectively and efficiently.

Implementation of the various recommendations typically required one of three types of action: administrative, regulatory, or statutory. For example, administrative action was taken to implement a paperwork reduction suggestion made by the State of Oregon. The State pointed out that certain progress reports, other monitoring reports, and the yearly application for Federal funds under the Justice Department's Office of Juvenile Justice programs all required reporting of the same information. Oregon recommended that the Justice Department require the submission of only the annual monitoring report and eliminate the same information in the annual progress report. The Department adopted this recommendation, and the revised reporting requirements are now in effect.

Actions requiring notice and comment rulemaking are more complex and take longer to complete because of the time needed to draft a notice of proposed rulemaking, analyze public comment, and draft a final rule that takes into consideration all comments received. Consequently, implementation of some of the NGA recommendations requiring regulatory action has only recently been completed, while other regulatory proposals have been published for comment but are not yet final.

In response to concerns from Nebraska and other States, the Departments of Agriculture and Health and Human Services are revising regulations governing the processing of eligibility determinations for Aid to Families with Dependent Children (AFDC) and Food Stamps. Because of differences between the two programs, States have to process the same eligibility information twice. A proposed rule to permit States to process some eligibility information only once was issued in September 1987. A final rule will be issued before October 1988.

Still other NGA recommendations required statutory change for implementation. The State of Missouri, for example, was concerned that teenage girls in foster care who became mothers were being excluded from receiving benefits under the AFDC and Medicaid programs. The problem was that foster care payments were being considered as income in AFDC and Medicaid eligibility determinations. Two statutory changes have ameliorated this problem. First, the Tax Reform Act of 1986 specified that foster care payments under Title IV-E of the Social Security Act were not to be counted as income of the family. Second, Section 9133 of the Omnibus Reconciliation Act of 1987 provided that in cases where teenage girls receiving Title IV-E foster care have children of their own, the foster care payment shall include a sum necessary for the care of both mother and the child. As a result of this latest statutory change, both parent and child are eligible to receive benefits under Medicaid.

Another recommendation requiring a statutory revision came from both North Dakota and the National Association of State Aviation Officials. Because of Federal budgetary constraints and improvements in State administrative capabilities, they suggested that States be permitted to administer Federal airport development grants. The Administration proposed legislation providing 22 percent of airport improvement funds to States through a block grant. Although Congress did not adopt this specific provision, it agreed to an experiment based on the concept of the Administration's proposal. The legislation enacted provided for a pilot program for up to three States to assume administrative responsibility for all airport grant funding other than for funding designated for use at primary airports. On December 30, 1987, the President signed into law this legislation, known as the "Airport and Airway Improvement Act Amendments."

In some instances the Administration used a combination of statutory and regulatory changes to implement State recommendations. The State of Washington, for example, endorsed a statutory change to permit State Medicaid, AFDC, and Food Stamp programs to develop more flexible procedures in eligibility determinations in lieu of the requirement to verify all sources of income for applicants. The Omnibus Reconciliation Act of 1986 provided such relief, and an interim rule published by the Department of Agriculture on February 2, 1988 (53 Federal Register 2817), is designed to give States total discretion in developing their targeting procedures, so long as they can demonstrate that they are cost-beneficial.

As another example the Association of State and Territorial Health Officials (ASTHO) recommended abolishing a requirement that States hold annual public hearings on their plans for the Department of Agriculture's Women, Infants, and Children (WIC) program. The recommendation was based on a widely shared view that the hearings served little purpose since few people attended them. Both a statutory change to eliminate the requirement, and a regulatory change (published in June 1987) requiring States to solicit public input but permitting them to establish a solicitation process of their choice, were used to implement ASTHO's recommendation.

Implementation of these and other NGA recommendations is one step in restoring the balance between the States and the Federal government, and an important one. The success of this project has depended, in large part, on the commitment of and close cooperation by the Governors, State officials, and Federal departments and agencies. Only through a process of open and frank communication between the Federal government and States and localities can Federal assistance programs be made more effective for the citizens they are intended to serve. The Administration believes this effort has significantly strengthened the communication process and hopes that it will lead to continued progress in improving governmental services at all levels in the years to come.

## FEDERALISM IN THE FUTURE

### Institutionalizing Federalism: Executive Order No. 12612

To ensure that Federalism principles are an enduring component of federal policymaking, President Reagan issued Executive order No. 12612 on October 26, 1987. This order, entitled simply "Federalism," sets forth fundamental principles and policymaking criteria by which Executive departments and agencies shall be guided in formulating and implementing policies that have Federalism implications.

The Federalism principles enunciated in Executive Order No. 12612 were developed earlier in the Administration by the Domestic Policy Council's Working Group on Federalism. The President formally transmitted these principles to the Cabinet on May 19, 1986. The principles were also published in the *Regulatory Program of the United States Government, April 1, 1985-March 31, 1986.* These principles help define the relationship between the Federal government and the States and localities. Under these principles, that relationship is based on a recognition of the limits of national government, the sovereign powers of the States and the people, and the competency and diversity of the States and local communities.

In addition to these fundamental principles the Order contains several criteria that agencies are to use when developing policies that affect the States and localities. Notable among these criteria are the following:

- Federal action limiting the policymaking discretion of the States should be taken only where constitutional authority is clear and certain and the national activity is necessitated by a problem of national scope.
- With respect to national policies administered by the States, the national government should grant the States the maximum administrative discretion possible.
- When undertaking to formulate and implement policies that have Federalism implications, Executive departments and agencies shall:

- Encourage States to develop their own policies to achieve program objectives and to work with appropriate officials in other States;
- Refrain, to the maximum extent possible, from establishing uniform national standards for programs and, when possible, defer to the States to establish standards; and
- When national standards are required, consult with appropriate officials and organizations representing States in developing those standards.

Of particular concern to States and Administration officials has been the tendency of Federal government in the past to ignore or disregard State law in the accomplishment of a Federal objective. To address this concern the order mandates that, to the extent permitted by law, departments and agencies construe a Federal statute to preempt State law only when there is an express preemption provision, or when there is "some other firm and palpable evidence" that Congress intended preemption of state law, or when exercise of State authority directly conflicts with the exercise of Federal authority under the Federal statute.

To ensure that the principles and criteria and other requirements contained in this order are followed, E.O. No. 12612 requires Executive departments and agencies to designate an official responsible for their strict implementation. These officials are to determine which proposed policies of the agency have sufficient Federalism implications to warrant the preparation of a Federalism Assessment. The assessment is to identify any provision of the policy that is inconsistent with the order's principles and policymaking criteria and to estimate the costs or burdens that the policy will impose on the States.

While E.O. 12612 is intended to be self-implementing, the Order also requires the Office of Management and Budget (OMB) to oversee its administration. In implementing its regulatory review authority under Executive Order Nos. 12291 and 12498 and its legislative review authority under OMB Circular No. A-19, OMB, to the extent permitted by law and consistent with those authorities, "shall take action to ensure that the policies of the Executive departments and agencies are consistent with the principles, criteria, and requirements" of the order.

### The National Governors' Association Project, Phase II

Another strong indication that the Administration's Federalism perspective will continue into the future is the ongoing effort of the National Governors' Association to identify ways to make Federal and State programs more efficient. As described above, on February 21, 1988, the Administration presented the Governors with a final report on implementation of almost 50 NGA recommendations for alleviating Federal administrative burdens. The next day Governor John Sununu, Chairman of the NGA, presented the President with over 160 new State proposals for Federal regulatory reform.

These new proposals, which affect 25 departments and agencies, cover a wide range of issues and programs. They include proposals for making Federal programs more helpful to their constituents, eliminating duplicative and conflicting regulations, permitting more reliance on State laws and procedures for the management of Federal programs, speeding up the Federal response to program management issues, updating Federal programs to meet new State needs, and alleviating Federal micromanagement of State and local affairs. The Administration has these proposals under review; several of them are already being adopted.

Some of the NGA proposals reflect a frustration with close Federal oversight of State-administered programs. Environmental Protection Agency (EPA), for example, has the authority to delegate the National Pollutant Discharge Elimination System (NPDES) Permit Program to the States. A major problem with this delegation, according to the State of Minnesota, is that EPA regional offices review major NPDES permits point by point, with the State not being allowed to issue the permit until all EPA concerns are satisfied. Minnesota recommended that EPA overview be limited to an overall evaluation of the success of the Permit Program in protecting water quality, within established guidelines, rather than actual review of all major NPDES permits. EPA is currently considering "differential delegation" of permit programs, such as NPDES, based on a State's performance. Under such an approach EPA would delegate additional administrative authority to those States with a proven record of effectively implementing program requirements. An EPA staff work group was scheduled to present proposals to the State/EPA Committee on July 19–20, 1988.

In another example the State of New Hampshire identified what it believed were unnecessary paperwork requirements and reporting procedures associated with Department of Transportation subcontracting requirements. Specifically New Hampshire recommended the elimination of requirements that States not permit subcontract work to be performed until they have reviewed the agreement and authorized the arrangement in writing. DOT has agreed with this recommendation and is notifying all Regional Administrators of this change in policy. In addition DOT is revising its Federal-Aid Highway Program Manual to reflect this change.

Some NGA proposals call for closer coordination and cooperation among the State and Federal partners. The State of Alabama, for example, identified several Federal statutory and regulatory barriers to providing cost-efficient public transportation services. Alabama recommended that since most of the Federal support for transportation services comes from the Department of Transportation and the Department of Health and Human Services (HHS), these two Federal agencies should closely work with State and local recipients of these funds to eliminate these barriers. The Joint DOT/HHS Council on Transportation Coordination met in June 1988 to review draft responses to many of the barriers identified by the States. The Council has developed a set of recommendations and clarfying information that will help State and local governments overcome these barriers. This information will be provided to States and localities in the near future.

Still other proposals concern agency policies and regulatory interpretations. The State of Nevada was concerned that residents living in trailer parks are not considered in determining eligibility for loans under the Department of Agriculture's (USDA's) Farmers Home Administration (FmHA) loan program, because trailer parks are considered to be commercial properties. USDA has responded that under existing regulations, all rural residents should be considered in determining loan eligibility, regardless of whether they live in a trailer park. FmHA has reviewed this interpretation with its Utah State Office, which serves Nevada.

The State of New Jersey proposed greater flexibility in compliance with regulations requiring States to maintain and use an income and eligibility verification system (IEVS) to verify program eligibility in the AFDC and Food Stamp programs. These regulations require States to request and verify wage information from a State source on a quarterly basis and from the Social Security Administration on an annual basis. These data bases, according to New Jersey, overlap to a large extent. The State proposes that States have the option, rather than be required, to request wage, self-employment, and pension information from SSA. Recent regulations issued by the Department of Agriculture and rules soon to be issued by the Department of Health and Human Services permit States to exclude SSA wage data if followed up previously from the State source.

These are only a few of the National Governors' Association's regulatory relief proposals that the Administration has decided to implement. A complete report will be issued to the NGA in early August.

## SUMMARY

Federalism is a long-standing, enduring philosophy dating back to the beginning of our Republic. Our system of government was founded on the notion that the power to govern this Nation belongs to the states unless designated to the central government—yet one more check on an overly powerful national government. But Federalism has become much more than a defense against tyranny. As this chapter has attempted to illustrate, Federalism is now considered a commonsense, effective way to govern. By using the special abilities and expertise of the States, the Nation can better assure that services are provided fairly and efficiently to its citizens.

While this Administration did not invent the Federalism concept, President Reagan has instilled it with a new and vigorous spirit. By promoting Federalism principles in Executive branch rulemaking, establishing a meaningful dialogue between the national government and the States, and promulgating an Executive order intended to steer Federal policymaking away from unwarranted intrusion into State and local affairs, this Administration has significantly enhanced the role of Federalism in American government. The challenge to future administrations is to build upon this foundation.

# *THE ROLE OF ECONOMIC ANALYSIS IN THE DEVELOPMENT OF RESPONSIBLE REGULATION*

Government regulation permeates everyday life, affecting among other things the labels on our foods, the design of our cars, the fabric of our clothes, and the air we breathe. Federal regulation continues to be one of the major ways that our government achieves basic societal goals, rivaled in influence on our daily lives only by tax and expenditure polices.

Regulations can make important contributions to the Nation's welfare. For example, the National Highway Traffic Safety Administration estimates that its Center High-Mounted Stop-Lamp regulation will annually prevent 40,000 injuries and over $400 million in property damage by reducing the number and severity of rear-end collisions. But these benefits are not free; the regulation is estimated to cost $70 million per year ($7 for each car). The resources used to meet these regulatory requirements are not available to meet other important requirements for the Nation's welfare, such as making cars with lower exhaust emissions. Consequently Federal regulatory actions will improve the Nation's welfare only if the societal benefits of the actions exceed the societal costs; i.e., if the net benefits are positive.

Over the last two decades, we have learned valuable lessons about the development and use of regulations. First, because our society is complex, regulating it is no easy task. Reaching an acceptable administrative resolution of complex regulatory issues requires extensive data collection, thorough analysis, and difficult legal, economic, and political decisions. Developing and enforcing a major regulation can absorb a large share of a regulatory agency's resources. And in the case of controversial rules there can be a protracted period of litigation, court review, and often remand to the agency for further work.

Second, Federal regulatory initiatives have often failed to achieve their objectives and, in some instances, have had unintended effects that have undermined the regulatory program. Effective regulation must anticipate the ingenuity of the regulated community and the ingrained reluctance of people to change behavior.

Finally, Federal regulation imposes substantial costs on the American economy by redirecting resources from other uses, both private and public, to meet regulatory requirements. Current estimates suggest that Federal regulatory costs may be as high as $150 billion per year; the Environmental Protection Agency (EPA) alone may be responsible for regulatory costs of $70 to $80 billion per year. And the cost of the Federal regulatory structure continues to increase as new regulations are added.

Over the last year, for example, two major Federal agencies — the Department of Labor and EPA — have issued major rules imposing additional regulatory costs of $2.2 billion per year.[86]

Because of the importance of understanding the effects of major regulations, President Reagan issued Executive Order No. 12291. This Order requires Federal agencies to analyze "the need for and consequences of proposed government action in order to design regulatory measures that, to the extent permitted by law, maximize net benefits to society." Among other things, Executive Order No. 12291 requires Executive branch agencies to prepare a regulatory impact analysis (RIA) for each major rule. The basic objective of the RIA requirement is to ensure that regulatory policymakers have the best information available on the likely benefits and costs of regulatory alternatives so they can make better decisions and to provide the public, Congress, and the courts with a better understanding of the basis for agency decisionmaking.

There are two fundamental questions that must be answered if an RIA is to be useful in helping to guide a rulemaking decision: (1) is there a genuine need for Federal regulatory action and (2) if so, under what conditions can the benefits of the action be expected to exceed its costs? To answer the first question, the agency must determine whether Federal regulation can accomplish the objective more efficiently than the market or some alternative to Federal regulation. If the answer to the first question is "no", there is no need to answer the second question unless statutory requirements mandate Federal regulation. To answer the second question, the agency must identify several alternative regulatory actions and evaluate the benefits and costs of each action while accounting for the uncertainty of those benefits and costs.

## ASCERTAINING THE NEED FOR FEDERAL REGULATORY ACTION

### The Theory of Markets

According to economic theory, competitive markets generally perform well in supplying the economic goods and services people want. Thus there is a strong presumption that government intervention into markets should only be undertaken when markets are not working, that is, where there is a so-called "market failure." Market failures can be divided analytically into three categories: externality,[87] public good (including problems arising

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[86] The cost of major EPA and Department of Labor regulations issued in 1987, in billions of 1987 dollars, is as follows:

| | Annual Cost | Present Value of Cost Over 30 Years |
|---|---|---|
| **Environmental Protection Agency** | | |
| *Pesticides and Toxic Substances* | | |
| Asbestos in Schools | $0.33 | $3.14 |
| *Water* | | |
| Organic Effluent Limitation | 0.53 | 4.90 |
| *Solid Waste and Emergency Response* | | |
| California List | 0.09 | 0.89 |
| Right to Know | 0.32 | 2.99 |
| *Air and Radiation* | | |
| PM10 | 0.17 | 1.66 |
| Industrial Boilers | 0.47 | 0.44 |
| **Department of Labor** | | |
| *Occupational Safety and Health* | | |
| Hazard Communication | 0.19 | 1.83 |
| Grain Handling | 0.04 to 0.07 | 0.39 to 0.65 |
| Benzene | 0.02 | 0.23 |
| Formaldehyde | 0.06 | 0.61 |
| Total | 2.22 to 2.25 | 17.08 to 17.34 |

Note: A more detailed explanation of how these cost estimates were derived is available upon request. The PM 10 estimate is incremental to the existing PM NSPS program.

[87] An externality occurs when one party's actions impose uncompensated costs or benefits on third parties not part of the market transaction. For instance, environmental problems, such as air emissions from a manufacturing plant, may impose soiling costs or health problems on neighbors.

from inadequate information),[38] and natural monopoly.[39] In order to establish the need for a Federal regulatory initiative, then, the RIA should first determine whether the proposed regulatory action addresses a genuine problem.

In theory the need to establish a market failure is fundamental, because there will be no net benefits to society (in fact there must be a net social loss) resulting from a regulatory action unless there is a market failure. Of course not all market failures can be remedied effectively through government regulation. In these instances the market solution, though imperfect, may be better than the regulatory alternative. An analysis of the underlying problems with the operation of markets should help determine the need for rulemaking.

In those instances in which legislation requires regulatory action without such analysis, RIAs should focus on the least burdensome means of achieving the statute's goals.

### Alternatives to Federal Regulation

If the agency identifies a need for governmental intervention, it must then decide whether Federal regulatory action is the best way to resolve the problem. There may be no need for Federal regulatory action if other approaches are more likely to resolve the problem. Such alternatives include: the judical system (for example, liability cases to discipline health and safety protection), antitrust enforcement, workers' compensation systems, and regulation at the State or local level.

In general, because demands among localities for different governmental services differ, and because competition among governmental units for taxpayers and citizens encourages efficient regulation, the agency should look to the lowest level of government (Federal, State, or local) capable of correcting the problem. In some cases the nature of the market failure itself may suggest the most appropriate governmental level of regulation. For example, pollution that spills across State lines is probably best controlled by Federal regulation, whereas localized pollution is probably more efficiently handled by local government regulation. In other instances, only a quantitative benefit/cost analysis can resolve the question, and the agency should include in its RIA an analysis of whether State or local government could more effectively achieve the regulatory goals.

## BENEFIT/COST ANALYSIS

If the agency determines that Federal regulatory action is necessary, then it must also prepare a benefit/cost analysis of the selected regulatory option and other suitable alternatives.[40] There are certain elements that play a crucial role in developing an effective benefit/cost analysis for policymaking purposes.

### Selection and Evaluation of Regulatory Options

Ordinarily the RIA should identify several regulatory options. One option, the status quo, normally serves as the base from which increments in benefits and costs are calculated for the other alternatives.[41] Other options the RIA should consider include varying degrees of stringency or varying dates of compliance. A failure to identify appropriate options substantially weakens the use of the RIA for decisionmaking, because it biases the analysis by effectively precluding consideration of alternatives that may be superior to the regulatory option selected by the agency.

In cases where an agency focuses on a specific "design" standard (a standard that mandates a specific technology), it should also evaluate a comparable regulatory option that achieves that same "performance" level without prescribing the method of compliance.[42] As the 1985 Regulatory Program pointed out, ". . . a regulation should focus on the goals to be achieved rather than on the specific technology or means used to achieve these goals. Setting performance standards in regulations is more efficient than specifying technological solutions (i.e., design standards) because they provide industry with the incentive to be innovative in finding the most cost-effective solutions . . . ."[43]

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[38] One type of "public good"—the provision of adequate information for buyers and sellers to make informed decisions in the marketplace—may also be a source of market failure. There are costs, though, as well as benefits in collecting and providing information. As a result a market failure occurs only in cases where the benefits substantially exceed the cost of providing additional information to the market. Where market failure due to inadequate information is the rationale for government action, a regulatory action to improve the availability of information, thereby allowing individuals to make informed decisions in their own best interest, will ordinarily be the preferred alternative. Food and Drug Administration ingredient labeling requirements and EPA's hazard labeling for pesticides exemplify this type of regulation.

[39] Natural monopoly exists where a market can be served at lowest costs only if production is limited to a single producer, as in the case of local telephone, gas, and electricity services. In this case regulation of the monopoly may be desirable because an unregulated monopolist will usually charge a higher price and produce and sell a smaller quantity than the price and quantity that would emerge in a competitive industry.

[40] Occasionally the agency may be prohibited by statute from relying on benefit/cost analysis in its decision to regulate. Even in this case, however, the Executive Order requires a benefit/cost analysis in order to inform the Congress, the courts, and the public of the rule's effects.

[41] If the status quo is an existing regulation, then the RIA should consider "no regulation" as an alternative.

[42] This point follows directly from Guideline #5 in the August 11, 1983 report of the Presidential Task Force on Regulatory Relief, "Reagan Administration Regulatory Achievements" and reaffirmed by E.O. No. 12498. It is also discussed above.

[43] Regulatory Program of the United States Government, April 1, 1985—March 31, 1986, p. xv.

### Benefit Estimates

The RIA should describe the beneficial effects of the proposed regulatory change and of its principal alternatives. In each case the agency should explain the way in which the proposed action is expected to yield the anticipated benefits. To the extent feasible, all potential benefits should be monetized—quantified in monetary terms (using constant dollars).[44] Any expected incremental benefits that cannot be monetized should be explained.

In developing benefits estimates the agency should: (1) clearly outline a causal link between the regulatory action and the expected benefits and (2) support its major assumptions and use sensitivity analysis (i.e., show a range of estimates) where appropriate. The identification of a causal link between the regulatory action and identified benefits is a key element of an RIA. The linkage between a regulatory action and the expected benefits of regulation frequently involves a complex sequence of steps. As a result there may be considerable uncertainty about the magnitude (and even the direction) of the effect of a regulatory action in some cases—particularly when the agency considers all the likely indirect effects as well.

#### *Principles for Valuing Benefits*

Ordinarily, goods and services should be valued at their market prices. In some instances, however, the market price of a good or service may not reflect its true value to society. If a regulatory action affects such a good or service, its monetary value for purposes of benefit/cost analysis should be derived using an estimate of its true value to society—often called its "shadow price." An example of a market price not reflecting a good's true value to society would be a commodity in a price support program where extra production is purchased by the government for storage.

#### *Valuation of Benefits Not Traded in the Market*

In some important instances a benefit does not correspond to a good or service traded in the marketplace. Important examples include reductions in health and safety risks, savings in time, and environmental amenities such as scenic vistas. To estimate the monetary value of a benefit that is not traded directly in the marketplace, the willingness-to-pay valuation approach is useful, because the amount that people are willing to pay for a good or service is often the best measure of its value to them. Willingness-to-pay estimates are derived from statstical analysis of labor or consumer markets or by using sophisticated consumer survey techniques.

Reductions in health and safety risks constitute one of the most important categories of nonmarket benefits. Both explicit and implicit methods can be used to incorporate these risk reductions into the framework of benefit/cost analysis. Among currently available methodologies, a widely accepted way to monetize explicitly reductions in fatality risks is to use the most likely estimate for the reduction in fatality risks times the willingness-to-pay estimate or the value of a unit risk reduction.[45]

An implicit valuation approach could be developed using calculations of the cost per unit of reduction in fatality risk (cost per "statistical life saved"), with costs defined as costs minus other monetized benefits.[46] Alternatives could then be arrayed in order of their total reduction in expected fatalities with the incremental cost per statistical life saved calculated between each adjacent pair of (the mutually exclusive) alternatives.

### Cost Estimates

The RIA should also include a schedule of monetized costs that shows the nature of the cost and when it would occur. The numbers in this table should be expressed in constant, undiscounted dollars. Costs include private-sector compliance costs, government administrative and enforcement costs, and costs of reallocating workers displaced as a result of the regulation. Costs that are not monetary outlays—for example, discomfort or inconvenience costs—must be included and should be assigned a monetary value wherever possible.

The important economic concept of opportunity costs is as relevant to benefit-cost analysis of regulations as it is to other types of economic analysis. The opportunity cost of an alternative is the value of the benefits foregone as a consequence of choosing that alternative. For example, the opportunity cost of banning a product (e.g., a drug, food additive, or hazardous chemical) is the loss of benefits to consumers of not being able to buy that product.

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[44] The RIA should include a schedule of monetized benefits that would show the type of benefit and when it would accrue; the numbers in this table should be expressed in constant, undiscounted dollars. Moreover, the RIA should identify and explain in detail the data or studies on which benefit estimates are based. Where benefit estimates are derived from a statistical study, the RIA should provide sufficient information, so that an independent observer can determine the representativeness of the sample and whether the results were used properly in developing aggregate estimates.

[45] The willingness-to-pay approach to valuing fatality risk reductions has recently been endorsed by a report prepared for the Administrative Conference of the United States. See Clayton P. Gillette and Thomas D. Hopkins, "Federal Agency Valuations of Human Life" (July 1988). While there is extensive literature yielding estimates on the value of small reductions in fatality risk, the available literature on willingness-to-pay estimates for small reductions in the risk of nonfatal illness or injury is far more limited. As a result, the analysis should reflect the best judgment on whether a willingness-to-pay study or a direct-cost valuation (e.g., medical costs and the value of lost production) provides a better estimate of the value of reducing the risk of nonfatal illness or injury.

[46] Gillette and Hopkins, *op. cit.*, also recommend to the Administrative Conference that: "Regulations that are adopted on the justification that they will save lives should state an explicit valuation utilized, or should disclose the value per statistical life implicit in that determination" (p. 62).

All costs calculated should be incremental, that is, they should represent changes in costs that would occur if the regulatory alternative is chosen compared to costs incurred under a less stringent alternative. Future costs that would be incurred even if the regulation is not promulgated, as well as costs that have already been incurred (sunk costs), are not part of incremental (or marginal) costs.

The RIA should explain any expected incremental costs that cannot be monetized. An important type of cost that often cannot be monetized is a slowing in the rate of innovation or of adoption of new technology. For example, regulations requiring a costly and time-consuming approval process for new products or new facilities may have such costs, as may regulations setting much more stringent standards for new facilities than for existing ones.

### Treatment of Risk and Uncertainty

Where benefit or cost estimates are heavily dependent on underlying assumptions, the RIA should make these assumptons explicit so that information on all elements of the analysis is fully apparent to users of the analysis (e.g., reviewing policymakers, Congress, and the public). Because the particular estimation approach adopted may involve a complicated model, it is important for the agency to make hidden assumptions explicit and present sensitivity analyses (i.e., show the effects of alternate assumptions on costs and benefits) based on plausible alternative assumptions.

Wherever benefit or cost estimates are uncertain, an agency should present "most likely" estimates (in statistical terms, unbiased estimates or expected values). Where possible, an agency should also present information about the likelihood that the true value is different from the estimate or at least present plausible lower and upper bound estimates. Often benefit/cost analyses rely on a number of different studies that yield a range of estimates. In these cases the midpoint of the range of extreme values provided by the studies does not represent the most likely estimate, because the most extreme estimates may be the least reliable. Such an approach ignores the results of the other studies. The correct approach would use all available information and derive a most likely estimate as a weighted average of the estimates of the individual studies, with the weight of each estimate based on the reliability of the study that produced it.

For many regulations the estimates of benefits are often less certain than the cost estimate. This is particularly the case where the benefits of regulation take the form of a reduction in health and safety risks. Costs can often be calculated by estimating the expenses of purchasing and installing new equipment or of adopting different work practices. On the other hand, benefits may be estimated on the basis of an hypothesized reduction in cancer cases, injuries, or crop damage.

Unfortunately this uncertainty on the health or benefit side is sometimes dealt with in a way that is inconsistent with the way it is generally dealt with on the cost side. Some agencies have adopted the practice of "erring on the side of safety" or adding "margins of safety" at each step in the risk assessment process. This means that the policy official usually does not know *how* conservative the benefit or risk reduction estimates are; just that they are conservative.

These practices, both informal and formal, are counterproductive to the provision of a safer and healthier society because it is impossible (given the bias in the risk estimates) to direct the limited resources available to produce the greatest reduction in risks. This danger is well recognized by policy analysts and scientists, especially those outside the regulatory agencies. For example, the National Academy of Science issued a report in 1983 recommending that:

> regulatory agencies take steps to establish and maintain a clear conceptual distinction between assessment of risks and consideration of risk management alternatives, that is, the scientific findings and policy judgments embodied in risk assessments should be explicitly distinguished from the political, economic, and technical considerations that influence the design and choice of regulatory strategies.[47]

If both the costs of regulations and the risk reductions they bring about are estimated using the expected value approach a realistic opportunity exists for obtaining the most risk reduction for society from a given level of expenditures.

## DISCOUNTING

Discounting takes account of the fact that resources (goods or services) in a given year are worth more than identical resources in a later year, since resources can be invested today so as to return more resources later. Because of this productvity of investment, the timing of benefits and costs must be taken into account. For example, a dollar invested today at 10 percent per year will return $2.59 in ten years. Thus the opportunity cost of a dollar foregone today is $2.59 in ten years. By the same argument, a regulatory benefit occurring today and worth $1.00 is equivalent to a benefit of $2.59 ten years from now. The appropriate way to account for such differences in the timing of benefits and costs is by discounting.

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[47] National Research Council, *Risk Assessment in the Federal Government: Managing the Process*. National Academy Press, Washington, DC 1983 p. 7.

If costs and benefits occur in different years, the RIA should evaluate the benefit and cost streams (in constant dollars) over a comparable timeframe. Generally the RIA would make the adjustment by discounting the benefit and cost streams to their present values, but there are alternative approaches that are equally valid, such as annualizing the benefit and cost streams over the appropriate timeframe.

## CRITIQUE OF RIAS

Last year's Regulatory Program examined some of the key elements of the RIA (as discussed above) in the context of nine RIAs covering a broad spectrum of regulatory actions. As a part of that review, the conclusion was reached that most of the RIAs represented a substantial improvement—particularly in terms of developing benefit estimates—over the economic analyses prepared under the procedures established in earlier years.

At the same time, however, some important shortcomings were identified. Some of these RIAs, OSHA's Asbestos standard RIA, for example, evaluated only a single regulatory option—the selected option.

In addition the treatment of uncertainty in some cases largely failed to convey the full scope of the uncertainty in the analysis. Some agencies, for example, had used "worst case" or "upper bound" estimates instead of most likely estimates in calculating the likely benefits of a regulation. In OSHA's RIA for ethylene oxide (Eto), the health risks are based on "worst-case" estimates of exposure in terms of both the concentration level and the duration of exposure. As a result, the combined effect of these "worst-case" assumptions yields an estimate of exposure risk five to ten times greater than the most likely estimate.

Most of the RIAs used some form of discounting as a way of addressing the problem of adjusting benefit and cost streams so that they could be considered in a comparable time frame. However, in some cases, RIAs only discounted the cost streams, without discounting the benefits. This is the case, for example, in OSHA's RIA for Eto. This differential treatment—discounting costs, but not benefits—can also be a significant source of bias in a benefit/cost analysis. In the Eto RIA, the cost per cancer avoided is increased by a factor of five if neither costs nor benefits are discounted and by more than a factor of ten if a consistent approach is adopted in discounting both benefits and costs.

Finally, once the benefits and costs have been estimated and placed on an equal footing by discounting future benefits and costs to the present and using the same basic methodology to produce "expected value" or most likely estimates, benefits and costs must be presented in some systematic format helpful to decision makers.[46]

In practice, however, many RIAs fail to develop an estimate of net benefits, either because statutes prohibit regulatory decisions based on benefit-cost evaluation or because the data needed for such calculations are simply unavailable. In these cases, RIAs

Table 1

RISK-COST TRADEOFFS FOR SELECTED REGULATIONS

| Regulation | Agency | Year issued | Cost per statistical life saved ($ millions) |
|---|---|---|---|
| Unvented space heaters | CPSC | 1980 | $ 0.07 |
| Servicing wheel rims | OSHA | 1984 | 0.25 |
| Fuel system integrity | NHTSA | 1975 | 0.29 |
| Fall protection | OSHA | 1985 | 1.40 |
| Uranium mill tailings (active) | EPA | 1983 | 53.00 |
| Ethylene oxide | OSHA | 1984 | 60.00 |
| Asbestos | OSHA | 1986 | 89.00 |
| DES ban in cattlefeed | FDA | 1979 | 132.00 |

Sources: *Regulatory Program of the United States Government*, April 1, 1986—March 31, 1987, p. xxi; Morrall, J. F., "A Review of the Record," *Regulation*, November–December 1986.

Note: In 1984 dollars, discounted at 10 percent. Each nonfatal accident requiring hospitalization is treated as equivalent to one-fiftieth of a fatality. This relationship was selected as representative of the willingness-to-pay values for fatality risks relative to injury risks found by research studies. Cancer is counted as a fatality. Cancer latency periods were assumed to be 15 years for lung cancer associated with uranium mill tailings, 30 years for mesothelioma and lung cancer associated with asbestos exposure, and ten years for the leukemia and breast cancer associated with ethylene oxide and DES, respectively.

Discounting benefits and costs at 4 percent instead of 10 percent does not affect the conclusion that there are extremely wide variations in cost per statistical life saved between these regulations, nor does it affect the cost-effectiveness rankings. Discounted at 4 percent, banning DES in cattlefeed still costs 1,500 times more per statistical life than regulating unvented space heaters.

should adopt cost-effectiveness analysis as a way of presenting this information in a systematic way. Unlike benefit-cost analysis, cost-effectiveness analysis does not require the monetization of benefits (although it does require the quantification of benefits).

Last year's Regulatory Program illustrated the usefulness of this type of analysis by presenting a table (reproduced here as Table I) of risk-cost tradeoffs for selected regulations from different agencies.

Once the cost-effectiveness estimates of the alternative regulatory options have been arrayed in a table, the relative merits of the alternatives considered are readily apparent. Table I shows that one million dollars spent per year in complying with OSHA's regulation on servicing wheel rims was estimated to save four "statistical lives" per year compared to two thirds of a "statistical life" every ten years for its Ethylene Oxide rule. Clearly if OSHA could mandate that only one million dollars per year of additional private resources could be spent on health and safety improvement, it would do well to consider issuing the wheel rim rule first.

The fact that Table I reveals a wide divergence in cost-effectiveness of risk-reducing regulations does not necessarily mean that regulatory oversight has failed. Not all the information necessary for fair and efficient decisions is displayed in Table I. For example, not all regulatory options are listed (only a selected sample), different parties pay the costs of and benefit from the different regulations, and other values that matter to society such as individual freedoms and basic rights are not included. Nevertheless, the wide divergence in cost-effectiveness displayed in Table I as well as other studies like it is a strong indication that there is room for improvement.[49]

## SUMMARY

The analytical elements outlined above constitute the foundation of an effective and useful RIA. Adherence to these key elements will yield important improvements in the information provided to decisionmakers, resulting in better-designed regulations and potentially large net benefits to society as a whole. In addition improved analyses will help the public, Congress, and the courts understand agency regulatory decisions.

Last year's Regulatory Program started that OMB was in the process of drafting more specific guidance in preparing RIAs in order to provide continued improvements in regulatory analyses. Draft RIA guidelines are set out in Appendix V. OMB solicits comments on their completeness, usefulness, and appropriateness.

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[48] Executive Order No. 12291 requires that net benefits (benefits minus costs) be calculated and that regulatory decisions be made that maximize net benefits to the extent permitted by law.

[49] See John Morrall, "Regulating Risk: A Review of the Record," *Regulation* (Nov/Dec 1986) p. 30 and John Mendeloff, *The Dilemma of Toxic Substance Regulation*, (Cambridge, Mass.: MIT Press, 1988) p. 22.

## APPENDIX V

# Regulatory Impact Analysis Guidance[1]

A Regulatory Impact Analysis (RIA) should demonstrate that a proposed regulatory action satisfies the requirements of Section 2 of Executive Order No. 12291. To do so, it should show that:

- There is adequate information concerning the need for and consequences of the proposed action;
- The potential benefits to society outweigh the potential costs; and
- Of all the alternative approaches to the given regulatory objective, the proposed action will maximize net benefits to society.

The fundamental test of a satisfactory RIA is whether it enables independent reviewers to make an informed judgment that the objectives of Executive Order No. 12291 are satisfied. An RIA that includes all the elements described below is likely to fulfill this requirement. Although variations consistent with the spirit and intent of the Executive Order may be warranted for some rules, most RIAs should include these elements.

The guidance in this document is not in the form of a mechanistic blueprint, for a good RIA cannot be written according to a formula. Competent professional judgment is indispensable for the preparation of a high-quality analysis. Different regulations may call for very different emphases in analysis. For one proposed regulation, the crucial issue may be the question of whether a market failure exists, and much of the analysis may need to be devoted to that key question. In another case the existence of a market failure may be obvious from the outset, but extensive analysis might be necessary to estimate the magnitude of benefits to be expected from proposed regulatory alternatives. The amount of analysis (whether scientific, statistical, or economic) that a particular issue requires depends on how crucial that issue is to determine the best alternative and on the complexity of the issue.

Regulatory analysis inevitably involves uncertainties and requires informed professional judgments. Whenever an agency has questions about such issues as the appropriate analytical techniques to use or the alternatives that should be considered, it should consult with the Office of Management and Budget as early in the analysis stage as possible.

This document is written primarily in terms of proposed regulatory changes. However, it is equally applicable to the review of existing regulations. In the latter case, the regulation under review should be compared to a baseline case of no regulation and to reasonable alternatives.

## Elements of a Regulatory Impact Analysis

Preliminary and final Regulatory Impact Analyses of major rules should contain five elements. They are: (1) a statement of the potential need for the proposal, (2) an examination of alternative approaches, (3) an analysis of benefits and costs, (4) the rationale for choosing the proposed regulatory action, and (5) a statement of statutory authority. These elements are explained in sections I-V below.

### I. STATEMENT OF POTENTIAL NEED FOR THE PROPOSAL

In order to establish the potential need for the proposal, the analysis should demonstrate that (a) market failure exists that is (b) not adequately resolved by measures other than Federal regulation.

#### A. Market Failure

The analysis should determine whether there exists a market failure that is likely to be significant. Once such market failure has been identified, the analysis should show how adequately the regulatory alternatives to be considered address the specified market failure. The three major types of market failure are externality, natural monopoly, and inadequate information.

1. *Externality*. An externality occurs when one party's actions impose uncompensated benefits or costs on another outside the marketplace. Environmental problems are a classic case of externality. Another example is the case of common property resources that may become congested or overused, such as fisheries or the broadcast spectrum. A third example is a "public good," such as defense or scientific research, whose distinguishing characteristic is that it is inefficient, or impossi-

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[1] This appendix was mainly written by Michael Mazur as one of his last projects before his untimely death last year. Those who knew Mike will appreciate his hard work and careful analysis that made this guidance possible.

ble, to exclude individuals from its benefits.

2. *Natural monopoly.* Natural monopoly exists where a market can be served at lowest cost only if production is limited to a single producer. Local telephone, gas, and electricity services are examples.
3. *Inadequate information.* The optimum, or ideal, level of information is not necessarily the maximum possible amount, because information, like other goods, should not be produced when the costs of doing so exceed the benefits. The free market does not necessarily supply an optimal level of information, because information once generated can be disseminated at little or no marginal cost and because it is commonly infeasible to exclude nonpayers from reaping benefits from the provision of information by others. Where market failure due to inadequate information is the rationale for government intervention, a regulatory acton to improve the availability of information will ordinarily be the preferred alternative.

The current state of knowledge about the economics of information is not highly developed. Therefore, regulatory intervention to address an information problem should only be undertaken where there is substantial reason to believe that private incentives to provide information are seriously inadequate and that the specific regulatory intervention proposed will provide net benefts for society.

In many circumstances, the availability of information, while perhaps not optimal, is reasonably adequate, so that attempts to regulate information are as likely to make things worse as to make them better. Information about a particular characteristic of a product, for example, would be reasonably adequate if buyers could determine the existence of the characteristic by inspection of the product before purchase or (in the case of a frequently purchased product) by use of the product. Even if the characteristic could not be determined by buyers, government intervention would not be warranted where sellers have incentives to reveal the existence of the characteristic to buyers. Sellers will have substantial incentives to supply information about any characteristic that is important to buyers and valued positively by them, particularly if the level of the characteristic varies between the products of one seller and another. In these circumstances sellers whose products rank highly in the valued characteristic can increase their sales by informing buyers of the superiority of their products. If the level of the characteristic does not vary between the products of one seller and another, individual sellers have less incentive to inform buyers about the characteristic. Even so, the incentives of individual sellers or of a trade association to supply information may be substantial.

Sellers are least likely to supply adequate information about a particular characteristic of their product where the characteristic is negatively valued by consumers and the level of the characteristic does not vary between the products of one seller and those of another (e.g., cholesterol in eggs). Even in such circumstances, substantial information about the characteristic may be available to buyers. For example, sellers of rival products may supply the information (e.g., while sellers of butter may have no incentive to tell buyers about cholesterol in butter and its possible consequences, sellers of margarine do have such an incentive). Where the negative characteristic involves a health or safety hazard, the threat of future product liability lawsuits may give sellers adequate incentives to reveal information about the potential hazard. News media, consumer groups, public health agencies, and similar services may supply information not supplied by sellers. In summary, while it is possible to identify situations in which market failure due to inadequate information is more likely to warrant regulatory intervention, each situation must be examined on a case-by-case basis.

There should be a presumption against the need for certain types of regulatory actions, except in special circumstances. A particularly demanding burden of proof is required to demonstrate the potential need for any of the following types of regulations:

- Price controls in competitive markets
- Controls on producton or sales in competitive markets
- Mandatory uniform quality standards for goods or services, unless they have hidden safety or other defects and the problem cannot be adequately dealt with by voluntary standards or information disclosing the hazard to potential buyers or users
- Controls on entry into employment or

production, except

(a) where indispensable to protect health and safety (e.g., FAA tests for commercial pilots), or

(b) to manage the use of common public resources (e.g., fisheries, airwaves, Federal lands, and offshore areas).

### B. Other Alternatives

Even where a market failure exists, there may be no need for Federal regulatory intervention if other means of dealing with the market failure resolve the problem adequately or better than the proposed Federal regulation would. Among the alternative means that may be applicable are the judicial system (particularly liability cases to deal with health and safety), antitrust enforcement, and workers' compensation systems.

An important alternative that may often be relevant is regulation at the State or local level. In determining whether there exists a potential need for a proposed Federal regulation, the analysis should examine whether regulation at the Federal level is more appropriate than regulation at the State or local level. This analysis may support regulation at the Federal level where rights of national citizenship (such as legal equality among the races) or considerations of interstate commerce are involved. If interstate commerce is involved, the analysis should attempt to determine whether the burdens on interstate commerce arising from different State and local regulations are so great that they outweigh the advantages of diversity and local political choice. In some cases the nature of the market failure may itself suggest the most appropriate governmental level of regulation. For example, pollution that spills across state lines (such as acid rain whose precursors are transported widely in the atmosphere) is probably best controlled by Federal regulation, while localized pollution (such as garbage truck noise) is probably more efficiently handled by local government regulation.

In general, because demands among localities for different governmental services differ and because competition among governmental units for taxpayers and citizens may encourage efficient regulation, the smallest unit of government capable of correcting the market failure should be chosen. This must, however, be balanced against the possibility of higher costs because national firms would be required to comply with more than one set of regulations and because administering similar regulations in more than one governmental unit involves some costs of duplication. Thus, some analysis may be necessary to determine which level of government can most efficiently regulate a specific market failure.

If the analysis does suggest a potential need for a Federal action, it should also consider alternatives of nonregulatory Federal measures. For example, as an alternative to requiring an action or the use of a particular product, it may be more efficient to subsidize it. Similarly, a fee or charge may be a preferable alternative to banning or restricting a product or action. An example would be an effluent discarge fee, which has been recommended as an efficient way to limit pollution because it causes pollution sources with different marginal costs of abatement to control effluents in an efficient manner. In addition, legislative measures that make use of economic incentives, such as changes in insurance provisions or changes in property rights, should be considered.

## II. AN EXAMINATION OF ALTERNATIVE APPROACHES

The RIA should show that the agency has considered the most important alternative approaches to the problem and must provide the agency's reasoning for selecting the proposed regulatory change over such alternatives. Ordinarily, it will be possible to eliminate some alternatives by a preliminary analysis, leaving a manageable number of alternatives to be evaluated by quantitative benefit-cost analysis according to the principles to be described in Section III. The number and choice of alternatives to be selected for detailed benefit-cost analysis is unavoidably a matter of judgment. There must be some balance between thoroughness of analysis and practical limits to the agency's capacity to carry out analysis.

Alternative regulatory actions that should be explored include the following:

1. *More performance-oriented standards for health, safety, and environmental regulations.* Performance standards are generally to be preferred to engineering or design standards because they allow the regulated parties to achieve the regulatory objective in the most cost-effective way. In general, a performance standard should be preferred wherever that performance can be measured or reasonably imputed. Performance standards should also be applied as broadly as possible without creating too much variation in regulatory benefits; for example, by set-

ting emission standards on a plant-wide or firm-wide basis rather than source by source. It is misleading and inappropriate, however, to characterize a standard as a performance standard if it is set so that there is only one feasible way to meet it; as a practical matter, such a standard is a design standard.

2. *Different requirements for different segments of the regulated population.* For example, there might be different requirements for large and small firms. If such a differentiation is made, it should be based on perceptible differences in the costs of compliance or in the benefits to be expected from compliance. For example, some worker safety measures may exhibit economies of scale, that is, lower costs per worker protected in large firms than in small firms. A heavier burden should not be placed on one segment of the regulated population on the grounds that it is better able to afford the higher cost; this is a sure formula for loading disproportionate costs on the most productive sectors of the economy.
3. *Alternative levels of stringency.*In general, both the benefits and costs associated with a regulation will increase with the level of stringency (although costs will eventually increase more rapidly than benefits). It is important to consider alternative levels of stringency to better understand the relationship between stringency and benefits and costs. This approach will increase the information available to the decisionmaker on the option that maximizes net benefits.
4. *Alternative effective dates of compliance.*The timing of a regulation may also have an important effect on its net benefits. For example, costs of a regulation may vary substantially over different compliance dates for an industry that requires a year or more to plan its production runs efficiently. In this instance a regulation whose requirements provide sufficient lead time is likely to achieve its goals at a much lower overall cost than a regulation that is effective immediately.
5. *Alternative methods of ensuring compliance.* Compliance alternatives include the appropriate entity (local, State or Federal) to enforce compliance, whether compliance is enforced by on-site inspection or periodic reporting, and structuring compliance penalties so that they provide the most appropriate incentives.
6. *Informational measures.* Measures to improve the availability of information include government establishment of a standardized testing and rating system (the use of which could be made mandatory or left voluntary), mandatory disclosure requirements (e.g., by advertising, labeling, or enclosures), and government provision of information (e.g., by government publications, telephone hot-lines, or public interest broadcast announcements). If intervention is necessary to address a market failure arising from inadequate information, informational remedies will generally be the preferred approaches. As an alternative to a mandatory standard, a regulatory measure to improve the availability of information has the advantage of being a more market-oriented approach. Thus, providing consumers information about concealed characteristics of consumer products gives consumers a greater choice than banning these products (for example, consumers are likely to benefit more from information on energy efficiency than from a prohibition on sale of appliances or automobiles falling below a specified standard of energy efficiency).

Except for prohibiting indisputably false statements (whose banning can be presumed beneficial), specific informational measures must be evaluated in terms of their benefits and costs. Paradoxically, the current state of knowledge does not generally permit the benefits and costs of informational remedies to be measured very accurately. Nonetheless, it is essential to consider carefully the costs and benefits of alternative informational measures, even if they cannot be quantified very precisely. Some effects of informational measures can easily be overlooked. For example, the costs of a mandatory disclosure requirement for a consumer product include not only the obvious cost of gathering and communicating the required information, but also the loss of any net benefits of information displaced by the mandated information, the cost of any inaccurate consumer interpretation of the mandated information, and any inefficiencies arising from the incentive that mandatory disclosure of a particular characteristic gives to producers to overinvest in improving that specific characteristic of their products.

Where information on the benefits and costs of alternative informational measures is insufficient to provide a clear choice between them, as will often be the case, the least intrusive alternative sufficient to accomplish the regulatory objective should be chosen. For example, it will often be sufficient for government to establish a standardized testing and rating system without mandating its use, because firms that score well according to the system will have ample incentive to publicize the fact.

7. *More market-oriented approaches*. In general, alternatives that provide for more market-oriented approaches, with the use of economic incentives replacing command-and-control requirements, should be explored. Market-oriented alternatives that may be considered include fees, subsidies, penalties, marketable rights or offsets, changes in liabilities or property rights, and required bonds, insurance or warranties (in many instances, implementing these alternatives will require legislation).

## III. ANALYSIS OF BENEFITS AND COSTS

### A. General Principles

The preliminary analysis called for by Sections I and II should have narrowed the number of alternatives to be considered by quantitative benefit-cost analysis to a workable number. Ordinarily, one of the alternatives will be to promulgate no regulation at all, and this alternative will commonly serve as the base from which increments in benefits and costs are calculated for the other alternatives. Even if the alternative of no regulation is not permissible statutorily, it is often desirable to evaluate benefits and costs to determine if statutory change would be desirable.

In some cases the desirability of specific alternatives outside the scope of the agency's regulatory authority may be determined by use of basic economic concepts in light of the principles enumerated in Section I. In other instances, however, only a quantitative benefit-cost analysis can resolve the question, and such alternatives will need to be included in the analysis of this section. In addition, alternative forms of agency regulation will need to be evaluated by quantitative benefit-cost analysis.

1. *Evaluation of Alternatives*. Except where prohibited by law, the primary criterion for choice among alternatives is expected net benefit (benefits minus costs). Other criteria may sometimes produce equivalent results, but they must be used with care to avoid the potentially serious pitfalls to be explained in Part B of this section and in Section IV. Both benefits and costs should be expressed in discounted constant dollars. Appropriate discounting procedures are discussed in the following section.

The distinction between benefits and costs in benefit-cost analysis is somewhat arbitrary, since a positive benefit may be considered a negative cost, and vice versa, without affecting the net benefit (benefits minus costs) decision criterion. This implies that the considerations applicable to benefit estimates also apply to costs and vice versa. The different issues are considered separately under benefits or costs in Sections B and C below according to where they most often arise.

If the proposed regulation is composed of a number of distinct provisions, it is important to evaluate the benefits and costs of the different provisions separately. The interaction effects between separate provisions (such that the existence of one provision affects the benefits or costs arising from another provision), may complicate the analysis, but does not eliminate the need to examine provisions separately. In such a case, the desirability of a specific provision may be appraised by determining the net benefits of the proposed regulation with and without the provision in question. Where the number of provisions is large and interaction effects are pervasive, it is obviously impractical to analyze all possible combinations of provisions in this way. Some judgment must be used to select the most significant or suspect provisions for such analysis.

2. *Discounting*. The monetary values of benefits and costs occurring in different years should be discounted to their present values so that they are comparable. This is not the same as correcting for inflation. An inflation adjustment is made with a price index, whereas discounting to present value is done with a discount rate. Benefits and costs expressed in constant (i.e., unaffected by inflation) dollars must further be discounted to present values before benefits and costs in different years can be added together to determine overall net benefits.

Discounting takes account of the fact that resources (goods or services) in a given year are worth more than identical resources in a later year. The underlying reason for this is that resources can be invested so as to return more resources later. Partly because of this productivity of investment, individuals value consumption in earlier years higher than consumption in later years.

Modern analysis of discounting for public programs stresses the distinction between two rates of return:

- The *before-tax* rate, also known as the opportunity cost of capital. This is the real rate of return to marginal private investments. Estimates of the opportunity cost of capital in the U.S. economy vary substantially. The 10 percent discount rate specified by OMB Circular A-94 for use in evaluating government programs is intended to represent the opportunity cost of capital.
- The *after-tax* rate, also known as the consumption rate of interest. This represents the rate at which consumers would be willing to exchange present for future consumption, that is, the rate at which consumers must be compensated for postponing their consumption. As with the opportunity cost of capital, alternative estimates of the consumption rate of interest vary significantly. A rate of four percent is reasonably representative of the range of alternative estimates and consistent with a 10 percent before-tax rate of return.

The basic concept underlying the academic literature on public-sector discounting is that economic welfare is ultimately determined by consumption and only indirectly by investment. Therefore, the value of investment must be measured by the value of the subsequent increase in consumption it permits. Any effect that a government program has on investment must be converted to an equivalent time-stream of consumption before being discounted. In practice, this results in a complex procedure that uses the before-tax and after-tax discount rates, a "shadow price of capital," and the impacts of benefits and costs on investment. It is recommended that agencies continue to use the well-understood procedure of discounting by a single rate (as specified by OMB Circular A-94) and, when appropriate, perform additional analysis using the more complex shadow-price-of-capital methodology.

There are two circumstances when it is important to perform sensitivity analysis using the shadow price of capital approach:

(a) Where the costs of the regulation are almost entirely current costs borne by consumers. In such circumstances a low rate close to four percent is called for. (This assumes, as is normally the case, that the benefits are all in the form of disposable income or other benefits directly to individuals.)

(b) Where some of the costs are capital costs financed out of saving *and* there is a long period between the time when most costs are incurred and the time when most benefts accrue. In general, the *smaller* the fraction of costs that are capital costs financed out of saving and the *longer* the time period between costs and benefits, the greater the likelihood that the shadow price of capital approach will be correct.

It is conceptually incorrect to adjust the discount rate as a device to account for the uncertainty of expected future benefits and costs. This procedure will virtually never lead to a correct adjustment of benefits and costs. Therefore, risk and uncertainty should be dealt with according to the principles in Section 3 below and not by changing the discount rate.

3. *Treatment of Risk and Uncertainty.* Where uncertainties exist about important parameters affecting the expected benefits or costs of an alternative under consideration, it is essential to carry out a *sensitivity analysis* to determine the effect on net benefits of plausible variations in the value of the parameters. One form of sensitivity analysis involves calculation of the "switch-point" value of the parameter under examination, that is, the value of the parameter at the break-even point at which the net-benefit decision criterion switches over from favoring one alternative to favoring another. When this break-even point of the parameter value is determined, the analysis may then consider the probability that the true parameter value is above or below the break-even value. For example, if the major uncertainty about a proposed regulation were its cost, the analysis could calculate how high the cost would need to be in order to reduce the net benefit of the proposal to zero. If it is judged to be highly unlikely that the actual cost would be that high or higher, it may be concluded that the choice of the proposed alternative is not sensitive to uncertainties about its cost.

A primary objective of sensitivity analysis is to identify where additional analysis may be most needed. If the choice of a specific regulatory action is sensitive to alternative parameter values that are about equally likely to be true, more research to better determine the true parameter value could be very valuable.

Wherever parameter estimates are uncertain, for either benefits or costs, most-likely estimates (in statistical terms, unbiased estimates or expected values) should be presented. Hypothetical best-case or worst-case estimates may be presented as alternatives for sensitivity analysis. Where possible, information about the probability distribution of the parameter estimate should be presented.

A common situation that arises in estimating both benefits and costs is that a number of different studies may exist which together provide a range of different estimates for a particular parameter. In general, it is not appropriate to use the midpoint of the range of extreme values provided by the studies. Such a technique ignores the information provided by all studies except those providing the extreme values, which may be the least reliable. The preferred approach to deriving a most-likely estimate of a particular parameter in this situation would be to derive it as a weighted average of the estimates of the individual studies, with the weight of each estimate being based on the reliability (in the best judgment of the agency) of the study that produced it.

Where expected future benefits or costs are uncertain, their value to those who receive them may be different from their value if they were certain. (Often, but not always, a certain future benefit is worth more to people than an uncertain future benefit with the same expected value.) As noted in the previous section, it is incorrect to adjust the discount rate as a device to account for the riskiness of futûre benefits or costs. Any allowance for risk should be made by adjusting the monetary values (for the year in which they occur) of the uncertain benefits and costs so that they are expressed in terms of their "certainty-equivalents."

For an uncertain benefit in future year X, the certainty-equivalent is the number of certain dollars in year X that the uncertain benefit is worth to its recipient. For example, suppose that a particular regulation reduces the probability of fire in a particular type of facility. As part of a benefit-cost analysis for this regulation, the dollar value of the expected reduction in fire loss would be calculated. The owners of the protected facilities place a higher dollar value on the risk of a fire than the expected dollar value of the loss. This is demonstrated by their willingness to pay for fire insurance. Therefore, their relative net cost (the percentage difference between insurance premiums and insurance company claim payments) for fire insurance can be used to increase the expected dollar value of the reduction in fire loss to its certainty-equivalent value.

In the example of the preceding paragraph, the adjustment for risk would involve an increase in the value of the benefit, whereas uncertainty of a benefit is normally thought to reduce its certainty-equivalent value. The reason is that even though this benefit by itself is uncertain, it acts to reduce the overall level of risk that would prevail in the absence of the regulation. This illustrates the important principle that what matters is not the variability or riskiness of a regulation's net benefits by themselves, but the regulation's effect on risk and uncertainty overall.

While an adjustment to account for risk may be called for in the fire-risk example given, a similar adjustment for the value of reductions in fatalities and injuries would not be appropriate. Assuming that the values of fatalities and injuries have been derived by the willingness-to-pay methodology recommended in section B.2 below, they would already represent the certainty-equivalent value of the uncertain risk. This is because the estimated dollar values represent the certain dollar amounts that individuals would sacrifice to reduce these risks.

Probably in most cases it will not be advisable to adjust for risk and uncertainty. As a theoretical matter, no adjustment for risk is necessary wherever the net benefits are widely dispersed among many individuals and are not correlated with disposable income. And in cases where this does not apply, risk may be relatively unimportant or may already be taken into account by use of the willingness-to-pay methodology. In other cases, there may be no practical way to quantify the value of changes in risk.

4. *Assumptions*. Where benefit or cost estimates are heavily dependent on certain assumptions, it is essential to make these assumptions explicit and, where alternative assumptions are plausible, to carry out sensitivity analyses based on plausi-

ble alternative assumptions. If the decision criterion proves to be sensitive to alternative plausible assumptions, this may necessitate further research to develop more evidence on which of the alternative assumptions is the most appropriate. Because the adoption of a particular estimation methodology sometimes implies major hidden assumptions, it is important to analyze estimation methodologies carefully to make hidden assumptions explicit.

5. *International Trade Effects.* In calculating the benefits and costs of a proposed regulatory action, generally no explicit distinction needs to be made between domestic and foreign resources. If, for example, compliance with a proposed regulation requires the purchase of specific equipment, the opportunity cost of that equipment is ordinarily best represented by its domestic cost in dollars, regardless of whether the equipment is produced domestically or imported. The relative value of domestic and foreign resources is correctly represented by their respective dollar values, because the foreign exchange value of the dollar is determined by a free exchange market. Nonetheless, an awareness of the role of international trade may be quite useful for assessing the benefits and costs of a proposed regulatory action. For example, the existence of foreign competition usually makes the demand curve facing a domestic industry more elastic than it would be otherwise. Elasticities of demand and supply frequently can significantly affect the magnitude of the benefits or costs of a regulation.

   A regulation that discriminates unjustifiably against foreign exporters is a form of economic protectionism. The economic loss to the U.S. due to the fact that protectionism is economically inefficient will be reflected in the net benefit estimate of any properly conducted benefit-cost analysis. However, a benefit-cost analysis will generally not be able to measure the potential U.S. loss from the threat of future retaliation by foreign governments. Therefore, special attention should be given to any possibility that a regulation would unjustifiably discriminate between domestic and foreign producers and consumers—both discrimination against foreigners and discrimination in favor of foreigners.

   The fact that a regulation has a differential effect on foreigners as compared to Americans does not necessarily constitute discrimination. If, for example, an automobile safety standard could be complied with less expensively b [illegible] ge cars than by small cars, such a standard would be more favorable to American car producers, who produce relatively more large cars compared to the fleet mix of foreign producers. Nonetheless, such a differential effect would not be discriminatory if the difference in compliance cost between large and small cars was necessary to achieve legitimate regulatory objectives in the most efficient way.

   If a regulation has an adverse differential effect on foreign producers or consumers relative to domestic producers and consumers that is not necessary to realize regulatory goals efficiently, then a discriminatory effect on foreign trade exists. The RIA should identify any substantial differential effect on international trade and explain why it is necessary to achieve legitimate regulatory goals in the most efficient way. One means for reducing the likelihood of international discrimination would be for a U.S. product standard for an internationally traded good to be based on an international standard, wherever an international standard exists and is compatible with the health, safety, or environmental needs of the U.S. International harmonization can be beneficial for regulations directly setting standards for internationally traded goods or services. For example, it would be appropriate to consider international harmonization in setting safety standards for automobiles. There is no similar advantage to international harmonization where a regulation does not directly affect the quality of an internationally traded good or service, even if it indirectly affects its costs (e.g., environmental controls for automobile plants).

## B. Benefit Estimates

The RIA should state the beneficial effects of the proposed regulatory change and its principal alternatives. In each case, there should be an explanation of the mechanism by which the proposed action is expected to yield the anticipated benefits. An attempt should be made to quantify all potential real incremental benefits to society in monetary terms to the maximum extent possible. A schedule of monetized benefits should be included that would show the type of benefit and when it would accrue; the numbers in this table should be expressed in constant, undiscounted dollars. Any expected incremental benefits that cannot be monetized should be explained.

The RIA should identify and explain in detail the data or studies on which benefit estimates are based. Where benefit estimates are derived from a statistical study, the RIA must provide sufficient information so that an independent observer can determine the representativeness of the sample, whether it was extrapolated from properly in developing aggregate estimates, and whether the results are statistically significant.

For regulations addressing health and safety risks, the calculation of potential benefits should derive from the agency's estimate of the mean expected value of the reduction in risk attributable to the standard. Estimates of the prevailing level of risk and of the reduction in risk to be anticipated from a proposed standard should be unbiased most-likely estimates rather than hypothetical worst-case estimates. Extreme safety or health results should be weighted (along with intermediate results) by the probability of their occurrence to estimate the expected result implied by the available evidence. In addition, to the extent possible, the distribution of probabilities for various possible results should be presented separately, so as to allow for an explicit margin of safety, where required, in final decisions. If a margin of safety is to be provided, the proper place for it is the final stage of the decision-making process, not by adjusting the risk or benefit estimates in a conservative direction at the information-gathering or analytical stages of the process. Conservative estimates should be presented as alternatives to best estimates for sensitivity analysis, but should not substitute for them.

It is important to guard against double-counting of benefits. For example, if a regulation improved the quality of the environment in a community, the value of real estate in the community might rise, reflecting the greater attractiveness of living in the improved environment. It would ordinarily be incorrect to include the rise in property values among the benefits of the regulation. Ordinarily, the value of environmental benefits (e.g., reduced health risks, scenic improvements) will already be included among the benefits. The rise in property values reflects the capitalized value of these improvements. Therefore, to count as benefits both the value of the environmental improvements and the corresponding increase in property values is to count the same benefits twice. Only where a direct estimate of the benefits has not been included would it be appropriate to include the increase in property values among the benefits.

1. *Principles for Valuing Benefits.* Ordinarily, goods and services are to be valued at their market prices. However, in some instances, the market value of a good or service may not reflect its true value to society. If a regulatory alternative involves changes in such a good or service, its monetary value for purposes of benefit-cost analysis should be derived using an estimate of its true value to society (often called its "shadow price"). For example, suppose a particular air pollutant damages crops. One of the benefits of controlling that pollutant will be the value of the crop saved as a result of the controls. If the price of that crop is held above the free-market equilibrium price by a government price-support program, it would overstate the value of the benefit of controlling the pollutant if the crop saved were valued at the market price established by the support program. The social value of the benefit should be calculated using a shadow price for crops subject to price supports. The estimated shadow price should reflect the value to society of marginal uses of the crop (e.g., the world price if the marginal use is for exports). If the marginal use is to add to very large surplus stockpiles, the shadow price would be the value of the last units released from storage, minus storage cost. Therefore, where stockpiles are large and growing, the shadow price is likely to be low and could well be negative.

In some important instances, a benefit does not correspond to a good or service traded in the marketplace. Important examples include reductions in health and safety risks, savings in time, and environmental amenities such as scenic vistas. To estimate the monetary value of a benefit that is not traded directly in the marketplace, the willingness-to-pay valuation methodology is conceptually superior, because the amount that people are willing to pay for a good or service is the best measure of its value to them. As noted in the following section, where there are practical obstacles to the accurate application of the willingness-to-pay methodology, alternative methods may be used. Methods for estimating the value of travel time include estimates based on wage rates and statistical studies of travelers' choices among alternative travel modes. Methods for estimating the value of environmental and recreational amenities include travel-cost and contingent-valuation estimation methods. The following section outlines the principles for valuing the most important type of nonmarketed benefit: reductions in health and safety risks.

2. *Valuation of Health and Safety Benefits.* For health and safety benefits, a distinction should be made between risks of nonfatal illness or injury and fatality risks.
   (a) *Nonfatal illness and injury.* Although the willingness-to-pay approach is conceptually superior, the current state of empirical research in the area is not sufficiently advanced to assure that estimates derived by this method are necessarily superior to direct-cost valuations of reductions in risks of nonfatal illness or injury. Any injury-value estimate from a willingness-to-pay study is necessarily an average over a specific combination of injuries of varying severity. If the average injury severity in such a study is greatly different from that for the regulatory action under study, then the study's estimated injury value may not be appropriate for evaluating that action. Accordingly, the agency should use whichever approach it considers most appropriate for the decision at hand. The primary components of the direct-cost approach are medical costs and the value of lost production. Possibly important costs that may be omitted by the use of the direct-cost approach are the value of pain and suffering, and the value of time lost from leisure and other activities that are not economically directly productive.

   (b) *Fatality.* Reductions in fatality risks are best monetized according to the willingness-to-pay approach. The value of changes in fatality risk is sometimes expressed in terms of the "value of life." This is something of a misnomer, since the value of a life really refers to the sum of many small reductions in fatality risk. For example, if the annual risk of death is reduced by one in a million for each of two million people, that represents two "statistical lives" saved per year (two million × one millionth = two). If the annual risk of death is reduced by one in 10 million for each of 20 million people, that also represents two statistical lives saved. The conclusion that the fatality risk reductions in these two cases are equivalent implies an assumption. The implicit assumption—that equal increments in risk are valued equally—allows different risk increments to be added together and compared directly. As a different example, suppose there are two alternative reductions in the annual risk faced by an individual:

A: from $.10 \times 10^{-6}$ to $.09 \times 10^{-6} = .01 \times 10^{-6}$
B: from $1.00 \times 10^{-6}$ to $.99 \times 10^{-6} =$
$.01 \times 10^{-6}$

Since in both cases the reduction in annual risk is the same ($.01 \times 10^{-6}$), the value of A and B should be considered the same.

The assumption that equal increments in fatality risk are of equal value is a legitimate one, so long as the level of fatality risk is below $10^{-4}$ annually. There is evidence that the willingness-to-pay value for increments in fatality risk does not change significantly over a wide range of risk exposure below $10^{-4}$ annually.

For levels of annual risk exposure of $10^{-4}$ and above, it cannot be assumed that equal increments of risk are valued equally. At these higher risk levels, it is particularly important to distinguish between situations of voluntary risk assumption and those of involuntary risk. Where the high risk is involuntary, it is appropriate to value reductions in risk from that high level more highly than equal risk reductions at lower risk levels. In general, the greater the risk that an individual bears, the higher will be the value the individual places on marginal changes in risk. On the other hand, where a high risk is chosen voluntarily those assuming the risk tend to be persons who place a relatively low value on averting safety risks. Empirical studies of risk premiums in high-risk occupations suggest that reductions in voluntarily assumed high risks should be valued less than equal risk reductions at ordinary risk levels.

Estimates of the value of fatality risks refer only to changes in an uncertain risk of death. They have no application to the certain prevention of the death of an identifiable individual.

3. *Alternative Frameworks for Health and Safety Benefits.* Several alternative ways of incorporating fatality risks into the framework of benefit-cost analysis may be appropriate. These may involve either explicit or implicit valuation of fatality risks.

One acceptable explicit valuation approach would be for the agency to select a single value for reductions in fatality risk at ordinary risk levels (below $10^{-4}$ annually) and use this value consistently for evaluating all its programs that affect ordinary fatality risks. Another acceptable explicit valuation approach would be to use a range of values for reductions in fatality risk and apply sensitivity analysis as with other parameters that have alternative plausible values. The range of alternative values should be a reasonable one, not one that includes the most extreme upper and lower values of fatality risk reduction that have been estimated. Extreme values are more appropriate for instances of extraordinarily high risks (above $10^{-4}$ annually), with the extreme low values being appropriate where voluntary assumption of high risk leads to self-selection and the extreme high values being appropriate where the high risk is involuntarily assumed.

Where the analysis uses a range of alternative values for reductions in fatality risk, it may be useful to calculate breakeven values, as in other sensitivity analyses. This requires calculating the borderline value of reductions in fatality risk at which the net benefit decision criterion would switch over from favoring one alternative to favoring another (i.e., the value of fatality risk at which the net benefits of the two alternatives are equal). This method will frequently be infeasible because of its computational demands or because alternatives are continuous rather than discrete (e.g., alternative stringencies for exposure levels), but where appropriate, it is a useful supplement to the sensitivity analysis.

An implicit valuation approach could entail calculations of the cost per unit of reduction in fatality risk (cost per "statistical life saved"), with costs defined as costs minus monetized benefits. This must be used with care, since there is a serious potential pitfall: It is *not* correct to choose between two mutually exclusive alternatives by selecting the alternative with lowest cost per statistical life saved. The alternative with higher cost per life saved may nonetheless be the alternative with the higher net benefit to society.

The way to avoid this pitfall while retaining the implicit valuation approach is to make all calculations of cost per life saved in terms of increments between alternatives. Alternatives should be arrayed in order of their total reduction in expected fatalities and the incremental cost per life saved calculated between each adjacent pair of alternatives. In contrast to explicit valuation approaches, this avoids the necessity of specifying in advance a value for reductions in fatality risks. However, a range of values will be implied by the final selection of an alternative. This range should be consistent with estimated values of reductions in fatality risks calculated according to the willingness-to-pay methodology.

Another way of expressing reductions in fatality risks is in terms of life-years saved. For example, if a regulation protected individuals whose average remaining life expectancy was 40 years, then a risk reduction of one fatality would be expressed as 40 life-years saved. Such a refinement may be desirable for regulations that disproportionately protect young people (e.g., motor vehicle safety regulations) or elderly people (e.g., regulations controlling carcinogens). To derive the value of a life-year saved from an estimate of the value of life, first determine the average remaining life expectancy of the sample population in the study from which the estimate was drawn. Assuming that the average age of the sample population is known, the average remaining life expectancy may be derived from actuarial tables giving life expectancy in relation to age. Using standard compound interest tables, the value of a life-year saved can then be determined as the estimated value of life annualized over a period equal to the number of years of remaining average life expectancy.

## C. Cost Estimates

1. *General Considerations.* The important economic concept of *opportunity cost* is relevant to benefit-cost analyses of regulations, as it is to other types of economic analyses. The opportunity cost of an alternative is the value of the benefits foregone as a consequence of that alternative. For example, the opportunity cost of banning

a product (e.g., a drug, food additive or hazardous chemical) is the foregone net benefit of that product. It is measured by changes in producers' and consumers' surpluses. (Producers' surplus is the difference between the amount a producer is paid for a unit of a good and the minimum amount the producer would accept to supply that unit. It is measured by the distance between the price and the supply curve for that unit. Consumers' surplus is the difference between what a consumer pays for a unit of a good and the maximum amount the consumer would be willing to pay for that unit. It is measured by the distance between the price and the demand curve for that unit.) As another example, even if a resource required by regulation does not have to be paid for because it is already owned by the regulated firm, nonetheless the use of that resource to meet the regulatory requirement has an opportunity cost equal to the net benefit it would have provided in the absence of the requirement. Any such foregone benefits for an alternative should be monetized wherever possible and either added to the costs or subtracted from the benefits of that alternative. Any costs that are averted as a result of an alternative should be monetized wherever possible and either added to the benefits or subtracted from the costs of that alternative.

All costs calculated should be incremental, that is, they should represent changes in costs that would occur if the regulatory alternative is chosen compared to costs in the base case (ordinarily no regulation or the existing regulaton). Future costs that would be incurred even if the regulation is not promulgated, as well as costs that have already been incurred (sunk costs), are not part of incremental costs. If marginal cost is not constant for any component of costs, incremental costs should be calculated as the area under the marginal cost curve over the relevant range.

Costs include private-sector compliance costs, government administrative costs and costs of reallocating workers displaced as a result of the regulation. Costs that are not monetary outlays must be included and should be attributed a monetary value wherever possible. Such costs may include the value (opportunity cost) of benefits foregone, losses in consumers' or producers' surpluses, discomfort or inconvenience, and loss of time. A schedule of monetized costs should be included that would show the type of cost and when it would occur; the numbers in this table should be expressed in constant, undiscounted dollars. Any expected incremental costs that cannot be monetized should be explained. An important type of cost that often cannot be quantified is a slowing in the rate of innovation or of adoption of new technology. For example, regulations requiring a costly and time-consuming approval process for new products or new facilities may have such costs, as may regulations setting much more stringent standards for new facilities than existing ones.

Two accounting cost concepts that should not be counted as costs in benefit-cost analysis are interest and depreciation. The time value of money is already accounted for by the discounting of benefits and costs. Depreciation is already taken into account by the time distribution of benefits and costs; the only legitimate use for depreciation calculations in benefit-cost analysis is to estimate the salvage value of a capital investment.

2. *Real Costs versus Transfer Payments.* An important, but sometimes difficult, problem in cost estimation is to distinguish between real costs and transfer payments. Transfer payments are not genuine costs, but payments for which no real good or service is received in return. Several examples of problems that may arise from the confusion between transfer payments and real costs (or benefits) may help to identify situations in which further analysis of the problem may be warranted. Monopoly profits, insurance payments, government subsidies and taxes, and distribution expenses are four potential problem areas.

   (a) *Monopoly profits.* If, for example, sales of a competitively produced product were restricted by a government regulation so as to raise prices to consumers, the resulting monopoly profits are not a benefit of the rule, nor is their payment by consumers a cost. The real benefit-cost effects of the regulation would be represented by changes in producers' and consumers' surpluses.

   (b) *Insurance payments.* Potential pitfalls in benefit-cost analysis may also arise in the case of insurance payments, which are transfers. Suppose, for example, a worker safety regulation, by decreasing employee injuries, led to reductions in firms' insurance premium payments. It would be incorrect to count the amount of the reduction in insurance premiums as a benefit of the rule. The proper measure of benefits is the value of the reduction in worker injuries, monetized as described previously, plus any reduction in real costs of administering insurance (such as the time of insurance company employees needed to process claims) due to the reduction in worker insurance claims. Reductions in insurance premiums that are matched by reductions in insurance claim payments are changes in transfer payments, not benefits.

(c) *Indirect taxes and subsidies*. A third instance where special treatment may be needed to deal with transfer payments is the case of indirect taxes (tariffs or excise taxes) or subsidies on specific goods or services. Suppose a regulation requires firms to purchase a $10,000 piece of imported equipment, on which there is a $1,000 customs duty. For purposes of benefit-cost analysis the cost of the regulation for each firm ordinarily would be $10,000, not $11,000, since the $1,000 customs duty is a transfer payment from the firm to the Treasury, not a real resource cost. This approach, which implicitly assumes that the equipment is supplied at constant costs, should be used except in special circumstances. Where the taxed equipment is not supplied at constant cost, the technically correct treatment is to calculate how many of the units purchased as a result of the regulation are supplied from increased production and how many from decreased purchases by other buyers. The former units would be valued at the price without the tax and the latter units would be valued at the price including tax. This calculation is usually difficult and imprecise, because it requires estimates of supply and demand elasticities, which are often difficult to obtain and inexact. Therefore, this treatment should only be used where the benefit-cost conclusions are likely to be sensitive to the treatment of the indirect tax. While costs ordinarily should be adjusted to remove indirect taxes on specific goods or services as described here, similar treatment is not warranted for other taxes, such as general sales taxes applying equally to most goods and services or income taxes.

(d) *Distribution expenses*. The treatment of distribution expenses is also a source of potential error. For example, suppose a particular regulation raises the cost of a product by $100 and that wholesale and retail distribution expenses are on average 50 percent of the factory-level cost. It would ordinarily be incorrect to add a $50 distribution markup to the $100 cost increase to derive a $150 incremental cost per product for benefit-cost analysis. Most real resource costs of distribution do not increase with the price of the product being distributed. In that case, either distribution expenses would be unchanged or, if they increased, the increase would represent distributor monopoly profits. Since the latter are transfer payments, not real resource costs, in neither case should additional distribution expenses be included in the benefit-cost analysis. However, increased distribution expenses should be counted as costs to the extent that they correspond to increased real resource costs of the distribution sector as a result of the change in the price or characteristics of the product.

### D. Expenditure Rules

Regulations establishing terms or conditions of Federal grants, contracts, or financial assistance call for a different form of regulatory analysis than do other types of regulation. In some instances, a full-blown benefit-cost analysis may be appropriate to inform Congress and the President more fully about the desirability of the program, but this would not ordinarily be required in a Regulatory Impact Analysis. The primary function of the RIA for this type of regulation should be to verify that the terms or conditions are the minimum necessary to achieve the purposes for which the funds were appropriated. They should not contain conditions in pursuit of goals that are not germane to the purpose for which the funds were authorized and appropriated. Beyond controls to prevent abuse and to ensure that funds appropriated to achieve a specific purpose are channeled efficiently toward that end, maximum discretion should be allowed in the use of Federal funds, particularly when the recipient is a State or local government.

## IV. RATIONALE FOR CHOOSING THE PROPOSED REGULATORY ACTION

The RIA should include an explanation of the reasons for choosing the selected regulation. Ordinarily, the regulatory alternative selected should be the one that achieves the greatest net benefits. If legal constraints prevent this choice, they should be identified and explained, and their net cost should be estimated.

Where uncertainties are substantial or a large proportion of benefits cannot be monetized, other methods of summarizing the benefit-cost analysis besides in the form of net benefits may sometimes be appropriate. When alternative forms of presentation are used, the objective must continue to be the maximization of net benefits (except where prohibited by law). Alternative criteria must be used with care because of the potential for errors or misinterpretation.

Agencies need not calculate the internal rate of return for a regulation. The internal rate of return is often difficult to compute and is problematical when multiple rates exist. It must not be used as a criterion for choosing between mutually exclusive alternatives. As a criterion for choosing between alternatives that are not mutually exclusive it has no advantages over the criterion of maximizing the present value of net benefits.

Benefit-cost ratios, if used at all, must be used with care to avoid a common pitfall. It is a mistake to choose among mutually exclusive alternatives by selecting the alternative with the highest ratio of benefits to costs. An alternative with a lower benefit-cost ratio than another may have the higher net benefits. Whether a regulation's benefits are greater (or less) than its costs can be determined by whether its benefit-cost ratio is greater (or less) than one. The benefit-cost ratio may be used as a very simplified indicator of the likely sensitivity of the result: If the benefit-cost ratio is much greater than one, the conclusion that regulation's benefits exceed its costs probably is not sensitive to likely alternative parameter values. If the ratio is only slightly greater than one, the conclusion probably is sensitive. The benefit-cost ratio may sometimes be acceptable as a rough substitute for genuine sensitivity analysis where it is not feasible to carry out a full sensitivity analysis (e.g., if the number of regulatory parameters to be tested by sensitivity analysis is large). When so used, the benefit-cost ratio should be recognized as only a crude approximation to a genuine sensitivity analysis and the analyst should be aware of its limitations (e.g., the benefit-cost ratio is sensitive to the arbitrary classification of an item as a benefit or an averted cost).

Where the benefits of proposed regulatory alternatives include reductions in fatality risks, an acceptable alternative to direct calculation of net benefits is the indirect approach of calculating incremental costs per life saved between adjacent alternatives. This is done by ranking all the alternatives according to the number of lives they save and then calculating the change in costs and the change in lives saved between each alternative and the one with the next highest number of lives saved. If the alternative selected is the one whose incremental cost per life saved is closest to the willingness-to-pay value of life, this decision criterion is analytically equivalent to that of maximizing net benefit.

In cases where important benefits cannot be assigned monetary values, cost-effectiveness analysis should be used where possible to evaluate alternatives that generate equivalent nonmonetizable benefits. Costs should be calculated net of monetized benefits. Between two alternatives with equivalent nonmonetizable benefits, the alternative with the lower net costs should be selected. Cost-effectiveness analysis should also be used to compare regulatory alternatives in cases where the level of benefits is specified by statute.

## V. STATUTORY AUTHORITY

The RIA should include a statement of determination and explanation that the proposed regulatory action is within the agency's statutory authority.

## Further Reading

Edith Stokey and Richard Zeckhauser, *A Primer for Policy Analysis*. Chapters 9 and 10 provide a good introduction to basic concepts.

E. J. Mishan, *Economics for Social Decisions: Elements of Cost-Benefit Analysis*. Assumes some knowledge of economics. Chapters 5-8 should be helpful on the important subjects of producers' and consumers' surpluses (not discussed extensively in this guidance document).

W. Kip Viscusi, *Risk By Choice*. Chapter 6 is a good starting point for the topic of valuing health and safety benefits. Other, more technical, sources are given in the bibliography.

National
Association of
Towns and Townships

# REGULATORY RELIEF PROGRAM FOR SMALL COMMUNITIES

October 6, 1987

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## CONTENTS

### Case Statement

A statement of the need for strict compliance with the Regulatory Flexibility Act, and suggestions for strengthening the Act.

### Appendices

Appendix I

Illustrative Examples: Noncompliance with Regulatory Flexibility Act

Appendix II

Illustrative Examples: Circumvention of Legislative Intent

Appendix III

Sec. 551, 553 of the Administrative Procedures Act

Appendix IV

P.L. 96-354, the Regulatory Flexibility Act

Appendix V

Suggested Legislative Changes

## CASE STATEMENT

## ADMINISTRATION ACTION ON REGULATORY RELIEF FOR SMALL COMMUNITIES

### BACKGROUND

For the past several decades, Washington has accelerated its use of federal regulations as a means to use state and local governments to carry out federally established policies on behalf of the national government. While the majority of these regulations were initially conditions of receipt of federal assistance, more recently Congress and the Administration have increased their use of outright or direct-order mandates which are not the result of participation in federal aid programs. Examples of such regulation include the creation of a 55 mph speed limit; the mandate for bilingual education in public schools; and a host of environmental regulations protecting the air, land and water.

In 1979, a National Science Foundation-funded research project discovered that local governments dealt with more than 1,000 federal and state mandates annually. Now, almost a decade later, the national government has yet to get a handle on the mandate situation. Rather than improving, the problem has grown far worse; and it now threatens the very health and stability of the nation's small governments and their local economies.

Small governments do not have a large staff of experts or other resources to respond to federal mandates. All too often, federal laws and regulations assume that all localities can absorb mandated new costs or administrative procedures; but the sad reality is that the vast majority of local governments have very little access to such expertise, and most are quickly approaching a financial breaking point.

The truth is that most of our nation's local governments are small--86 percent are under 10,000 people; 72 percent are smaller than 3,000, and fully half of all localities have fewer than 1,000 people. By and large, these governments provide essential services through the largely volunteer efforts of dedicated citizens--housewives, farmers, shopkeepers, and plumbers--everyday American folk who know little about the technical details of chemical seepage or hazardous materials spills, but could tell you a great deal about what their communities want, need, and can afford.

### "THE TAIL IS WAGGING THE DOG"

A large part of the problem is that federal requirements are generally designed with the larger local governments in mind--

often the 3 percent of localities with more than 50,000 inhabitants and which have the resources to comply; the opposite should be the case. As a result, federal rules are usually very prescriptive and extremely costly. While their goals are well-intended and often supported by local officials, local leaders are rarely given the opportunity to find more suitable alternatives.

More often than not, agencies arbitrarily set rigid standards without regard to local capacity. As a result, the requirements are unrealistic and usually cannot be met, especially by small localities; consequently, they afford no protection and are tantamount to doing nothing.

## THE REGULATORY FLEXIBILITY ACT

Consideration of less costly alternatives, a variety of technologies, varying levels of performance, or in some cases, outright exemptions from the rule should be an ongoing part of the regulatory process. In fact, Congress recognized the need to develop a flexible regulatory procedure which would consider the unique character and problems of small entities in the rule-making process; and as a result it enacted "The Regulatory Flexibility Act" in 1980.

This Act directs federal agencies "as a principle regulatory issuance," to "fit regulatory and information requirements to the scale of the business organizations, and **government jurisdictions** subject to regulation" (emphasis added). As a means to achieve this principle, the law requires agencies to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration.

Officials from small localities viewed the "Regulatory Flexibility Act" as a major positive development to deal with the problem of unrealistic regulatory expectations, but unfortunately the Act has not worked well, since federal agency personnel quickly found loopholes to avoid application of the Act's requirements.

Under the law, agency heads can certify that a proposed rule has "no substantial impact on a significant number of small entities" and waive analysis or consideration of alternative regulatory approaches. Agency heads are not required to prove by documentation that such is the case, and since the terms "substantial" and "significant" are relative terms, officials from small localities are hard pressed to prove otherwise. In reality, the burden of proof has been shifted from the federal agency which has resources to do an analysis, to the small local entity which has none.

No analysis of small governments' compliance with this Act is monitored by the Office of Advocacy of the Small Business Administration (the agency established by the law to be the "watch dog"). While the office has done a very good job ensuring compliance with the letter of the law for small businesses, its limited staff and lack of expertise regarding small governments has resulted in the office's inability to address the concerns of small localities.

As a result, federal agencies continue to issue unrealistic regulations which small entities cannot possibly meet; and agencies continue to ignore congressional intent in providing a flexible approach for regulatory policy.

Attached is a partial listing of recent federal regulations which are totally unrealistic. For each, we have noted the agencies "use" of the Act. There are three most common problems: 1. no Reg Flex analysis is performed; 2. the Reg Flex analysis confines itself to small businesses; and 3. no Reg Flex determination is included in the final rule.

## RECOMMENDED ACTION

We believe that the Regulatory Flexibility Act has great potential, but that a tightening of the law is necessary. NATaT will be working with Congress to make these improvements. In the meantime, there is much the Administration can do to improve this situation.

We recommend that the Administration issue a new regulatory reform executive order which will reaffirm the provisions included under E.O. 12044 and which would:

1. Require that regulatory flexibility analysis statements address small governments separately from and in addition to small businesses, even if the statement attests that there is no impact on these small governments. In addition, require that small governments be defined so as to break out the smallest governments (those below 10,000; those below 5,000), so that the majority of general purpose governments in the United States will receive equitable consideration.
2. Discourage the use of loopholes in conducting the necessary analyses required under the law by directing each agency to include a summary of the issues raised by public comment in response to the agency's initial regulatory flexibility analysis and the rationale for the agency's response to the

comment. Each agency should be required to demonstrate that its rule addresses the same concerns or indicates conclusively that its rule has no substantial impact on a significant number of small entities.

3. Require federal agency personnel to go well beyond present efforts to seek comments from small entities, soliciting comments through regional offices, representative national organizations and state organizations.

4. Create an Office of Advocacy for Small Entities in each federal agency similar to the Small and Disadvantaged Business Office currently within the Environmental Protection Agency, which would be appointed by and report directly to the head of the agency. The advocate would be empowered to review and analyze all regulatory actions under consideration by the agency and would provide information and assistance to small entities on regulatory activities within the agency, coordinate agency efforts to solicit small entities' views and make those views known to the agency.

   Require that all agency heads who certify that a proposed rule-making "has no substantial impact on a significant number of small entities" consult with the Advocate's office prior to invoking such a waiver, and that the Advocate's office comments to that certification be published in the agency announcement.

   Each federal agency would be required to provide resources and staff members commensurate with the responsibilities noted above. No small entity advocate could be fired without cause.

We believe that an Executive Order along the lines described above is necessary to ensure the realistic performance of small localities in regulatory policy. Without such encouragements, officials from small localities simply cannot comply.

# APPENDIX I

## ILLUSTRATIVE EXAMPLES: Noncompliance with Regulatory Flexibility Act

Date: 8/1/85
Agency: EPA
Action: Proposed Rule
Subject: Hazardous Waste Management Systems
Problem: Contains Reg Flex Statement but speaks only to small business

Date: 3/24/86
Agency: EPA
Action: Final Rule
Subject: Hazardous Waste Management Systems
Problem: Contains Reg Flex Statement but speaks only to small businesses

Date: 6/5/86
Agency: FmHA
Action: Final Rule
Subject: Community Facilities Loans/Grants; Servicing and Collections
Problem: Contains no Reg Flex Statement

Date: 9/2/86
Agency: Advisory Council on Historic Preservation
Action: Final Rule
Subject: Protection of Historic Properties
Problem: Contains no Reg Flex Statement

Date: 9/12/86
Agency: EPA
Action: Final Rule
Subject: Wastewater Treatment Construction Grant Program
Problem: Contains no Reg Flex Statement

Date: 11/7/86
Agency: EPA
Action: Final Rule
Subject: Hazardous Waste Management System; Land Disposal Restrictions
Problem: Contains Reg Flex Statement, but speaks only to small business

Date: 11/18/86
Agency: FmHA
Action: Final Rule
Subject: Rural Housing Loan Policies
Problem: Contains no Reg Flex Statement

Date: 3/23/87
Agency: Justice
Action: Proposed Rule
Subject: Immigration
Problem: Contains no Reg Flex Certification

Date: 4/17/87
Agency: EPA
Action: Proposed Rule
Subject: Underground Storage Tanks
Problem: Contains Reg Flex Statement, but speaks only to small business

Date: 8/10/87
Agency: EPA
Action: Proposed Rule
Subject: Hazardous Waste Operations and Emergency Response
Problem: Contains Reg Flex Statement, but speaks only to small business

## ILLUSTRATIVE EXAMPLES: Circumvention of Legislative Intent

### Interpretive Rules:

Date: 4/28/86

Agency: IRS

Action: Revenue Ruling

Subject: Medicare

Problem: Rather than go through the regulatory process, IRS issued this ruling which had an undeniably adverse impact on small governments which had no opportunity to comment.

Date: 10/20/86

Agency: EDA

Action: Interim Rule

Subject: Financial Assistance Requirements

Problem: Small governments will be affected by this rule, and their concerns should be recognized.

Date: 3/11/87

Agency: IRS

Action: Temporary Regulations
Final Regulations

Subject: Tax-Exempt Bond Information Reporting

Problem: This regulation goes far beyond "interpretation," since it proposed a revised information return form to be filled out for each issue of tax-exempt activity bonds. Increased paperwork is a particularly difficult problem for small governments, and should be addressed.

### Incorrect Certification

Date: 4/18/87

Agency: Labor Department

Action: Proposed Rule

Subject: Application of Fair Labor Standards Act to Employees of State and Local Governments

Problem: This Reg Flex statement certified that these regulations would result in a reduction of costs to public agencies.

If a thorough review and consultation had been done with local officials or their representatives, it would have become clear that these regulations do, indeed, have a significant impact on small government made invalid by taxpayer's request for reimbursement or government's failure to offer mileage and witness fees. United States v Awerkamp (1974, CA7 Ill) 497 F2d 832.

**3. Source of reimbursement**

Fees to witnesses and commissioner taking testimony were allowable from judiciary fund payment. 17 Op Atty Gen 247.

## SUBCHAPTER II. ADMINISTRATIVE PROCEDURE

### HISTORY; ANCILLARY LAWS AND DIRECTIVES

**Other provisions:**

**Prior similar provisions.** The provisions of 5 USCS §§ 551 et seq. were originally enacted by Act June 11, 1946, ch 324, 60 Stat. 237, popularly known as the "Administrative Procedure Act". That Act was repealed as part of the general revision of this Title by Act Sept. 6, 1966, and its provisions incorporated into 5 USCS §§ 551 et seq. and §§ 701 et seq.

### § 551. Definitions

For the purpose of this subchapter [5 USCS §§ 551 et seq.]—

(1) "agency" means each authority of the Government of the United States, whether or not it is within or subject to review by another agency, but does not include—

(A) the Congress;

(B) the courts of the United States;

(C) the governments of the territories or possessions of the United States;

(D) the government of the District of Columbia;

or except as to the requirements of section 552 of this title [5 USCS § 552]

(E) agencies composed of representatives of the parties or of representatives of organizations of the parties to the disputes determined by them;

(F) courts martial and military commissions;

(G) military authority exercised in the field in time of war or in occupied territory; or

(H) functions conferred by sections 1738, 1739, 1743, and 1744 of title 12 [12 USCS § 1738, 1739, 1743, and 1744]; chapter 2 of title 41 [41 USCS §§ 101 et seq.]; or sections 1622 [50 USCS Appx. § 1622], 1884, 1891–1902, and former section 1641(b)(2), of title 50, appendix

(2) "person" includes an individual, partnership, corporation, association, or public or private organization other than an agency;

(3) "party" includes a person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in an agency proceeding, and a person or agency admitted by an agency as a party for limited purposes;

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing;

(5) "rule making" means agency process for formulating, amending, or repealing a rule;

(6) "order" means the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing;

(7) "adjudication" means agency process for the formulation of an order;

(8) "license" includes the whole or a part of an agency permit, certificate, approval, registration, charter, membership, statutory exemption or other form of permission;

(9) "licensing" includes agency process respecting the grant, renewal, denial, revocation, suspension, annulment, withdrawal, limitation, amendment, modification, or conditioning of a license;

(10) "sanction" includes the whole or a part of an agency—

(A) prohibition, requirement, limitation, or other condition affecting the freedom of a person;

(B) withholding of relief;

(C) imposition of penalty or fine;

(D) destruction, taking, seizure, or withholding of property;

(E) assessment of damages, reimbursement, restitution, compensation, costs, charges, or fees;

(F) requirement, revocation, or suspension of a license; or

(G) taking other compulsory or restrictive action;

(11) "relief" includes the whole or a part of an agency—

(A) grant of money, assistance, license, authority, exemption, exception, privilege, or remedy;

(B) recognition of a claim, right, immunity, privilege, exemption, or exception; or

(C) taking of other action on the application or petition of, and beneficial to, a person;

(12) "agency proceeding" means an agency process as defined by paragraphs (5), (7), and (9) of this section;

(13) "agency action" includes the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act; and

(14) "ex parte communication" means an oral or written communication

**not on the public record with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports on any matter or proceeding covered by this subchapter.**

**Sept. 6, 1966, P. L. 89-554, § 1, 80 Stat. 381; (Sept. 13, 1976, P. L. 94-409, § 4(b), 90 Stat. 1247.)**

## HISTORY; ANCILLARY LAWS AND DIRECTIVES

**Prior law and revision:**

| *Derivation* | *U.S. Code* | *Revised Statutes and Statutes at Large* |
|---|---|---|
| (1) | 5 USC § 1001(a) | June 11, 1946, ch 324, § 2(a), 60 Stat. 237.<br>Aug. 8, 1946, ch 870, § 302, 60 Stat. 918.<br>Aug. 10, 1946, ch 951, § 601, 60 Stat. 993.<br>Mar. 31, 1947, ch 30, § 6(a), 61 Stat. 37.<br>June 30, 1947, ch 163, § 210, 61 Stat. 201.<br>Mar. 30, 1948, ch 161, § 301, 62 Stat. 99. |
| (2)-(13) | 5 USC § 1001 (less (a)) | June 11, 1946, ch 324, § 2 (less (a)), 60 Stat. 237. |

In para. (1), the sentence "Nothing in this Act shall be construed to repeal delegations of authority as provided by law," is omitted as surplusage since there is nothing in the Act which could reasonably be so construed.

In para. (1)(G), the words "or naval" are omitted as included in "military".

In para. (1)(H), the words "functions which by law expire on the termination of present hostilities, within any fixed period thereafter, or before July 1, 1947" are omitted as executed. Reference to the "Selective Training and Service Act of 1940" is omitted as that Act expired Mar. 31, 1947. Reference to the "Sugar Control Extension Act of 1947" is omitted as that Act expired on Mar. 31, 1948. References to the "Housing and Rent Act of 1947, as amended" and the "Veterans' Emergency Housing Act of 1946" have been consolidated as they are related. The reference to former 50 USC Appx § 1641(b)(2) is retained notwithstanding its repeal by Act Sept. 21, 1961, P. L. 87-256, § 111(a)(1), 75 Stat. 538, since § 111(c) of the Act provides that a reference in other Acts to a provision of law repealed by § 111(a) shall be considered to be a reference to the appropriate provisions of such Act Sept. 21, 1961.

In para. (2), the words "of any character" are omitted as surplusage.

In para. (3), the words "and a person or agency admitted by an agency as a party for limited purposes" are substituted for "but nothing herein shall be construed to prevent an agency from admitting any person or agency as a party for limited purposes".

In para. (9), a comma is supplied between the words "limitation" and "amendment" to correct an editorial error of omission.

In para. (10)(C), the words "of any form" are omitted as surplusage.

Commission business by commissioners and such "separate consideration" occurs where agenda material is circulated sequentially to individual commissioners when time is of the essence. 15-40 Broadcasting Corp. (1977) FCC 77-720, 42 AdL2d 86.

**3. Disclosure of national defense information**

FCC has clear authority in rulemaking, or adjudication, to receive, in camera, properly classified secret information that bears on national defense and Commission is required neither to disclose such information publicly nor to reveal substance of secret material in decision it subsequently might adopt. In Camera Presentation of Classified Information (1978) FCC 78-775, Dkt No. 18875, 44 AdL2d 502.

## § 553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title [5 USCS §§ 556 and 557] apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

**(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;**

**(2) interpretative rules and statements of policy; or**

**(3) as otherwise provided by the agency for good cause found and published with the rule.**

**(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.**

(Sept. 6, 1966, P. L. 89-554, § 1, 80 Stat. 383.)

## HISTORY; ANCILLARY LAWS AND DIRECTIVES

**Prior law and revision:**

| *Derivation* | *U.S. Code* | *Revised Statutes and Statutes at Large* |
|---|---|---|
| ..................... | 5 USC § 1003 | June 11, 1946, ch 324, § 4. 60 Stat. 238. |

In subsec. (a)(1), the words "or naval" are omitted as included in "military".

In subsec. (b), the word "when" is substituted for "in any situation in which".

In subsec. (c), the words "for oral presentation" are substituted for "to present the same orally in any manner". The words "sections 556 and 557 of this title apply instead of this subsection" are substituted for "the requirements of sections 1006 and 1007 of this title shall apply in place of the provisions of this subsection".

Standard changes are made to conform with the definitions applicable and the style of this title (5 USCS §§ 101 et seq.).

**Explanatory notes:**

A former 5 USC § 553 was transferred by Act Sept. 6, 1966, which enacted 5 USCS §§ 101 et seq., and now appears as 7 USCS § 2245.

**Other provisions:**

**Improving Government regulations.** Ex. Or. No. 12044, of Mar. 23, 1978, 43 Fed. Reg. 12661, provided:

"As President of the United States of America, I direct each Executive Agency to adopt procedures to improve existing and future regulations.

"Section 1. Policy. Regulations shall be as simple and clear as possible. They shall achieve legislative goals effectively and efficiently. They shall not impose unnecessary burdens on the economy, on individuals, on public or private organizations, or on State and local governments.

"To achieve these objectives, regulations shall be developed through a process which ensures that:

"(a) the need for and purposes of the regulation are clearly established;

"(b) heads of agencies and policy officials exercise effective oversight;

"(c) opportunity exists for early participation and comment by other Federal agencies, State and local governments, businesses, organizations and individual members of the public;

"(d) meaningful alternatives are considered and analyzed before the regulation is issued; and

# Appendix B

Public Law 96-354
96th Congress

## An Act

Sept. 19, 1980
[S. 299]

To amend title 5, United States Code, to improve Federal rulemaking by creating procedures to analyze the availability of more flexible regulatory approaches for small entities, and for other purposes.

Regulatory Flexibility Act.
5 USC 601 note.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Regulatory Flexibility Act".

### FINDINGS AND PURPOSES

5 USC 601 note.

Sec. 2. (a) The Congress finds and declares that—

(1) when adopting regulations to protect the health, safety and economic welfare of the Nation, Federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public;

(2) laws and regulations designed for application to large scale entities have been applied uniformly to small businesses, small organizations, and small governmental jurisdictions even though the problems that gave rise to government action may not have been caused by those smaller entities;

(3) uniform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and disproportionately burdensome demands including legal, accounting and consulting costs upon small businesses, small organizations, and small governmental jurisdictions with limited resources;

(4) the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity;

(5) unnecessary regulations create entry barriers in many industries and discourage potential entrepreneurs from introducing beneficial products and processes;

(6) the practice of treating all regulated businesses, organizations, and governmental jurisdictions as equivalent may lead to inefficient use of regulatory agency resources, enforcement problems, and, in some cases, to actions inconsistent with the legislative intent of health, safety, environmental and economic welfare legislation;

(7) alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes may be available which minimize the significant economic impact of rules on small businesses, small organizations, and small governmental jurisdictions;

(8) the process by which Federal regulations are developed and adopted should be reformed to require agencies to solicit the ideas and comments of small businesses, small organizations, and small governmental jurisdictions to examine the impact of proposed and existing rules on such entities, and to review the continued need for existing rules.

(b) It is the purpose of this Act to establish as a principle of regulatory issuance that agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration.

### ANALYSIS OF REGULATORY FUNCTIONS

Sec. 3. (a) Title 5, United States Code, is amended by adding immediately after chapter 5 the following new chapter:

### "CHAPTER 6—THE ANALYSIS OF REGULATORY FUNCTIONS

"Sec. 601. Definitions.
"Sec. 602. Regulatory agenda.
"Sec. 603. Initial regulatory flexibility analysis.
"Sec. 604. Final regulatory flexibility analysis.
"Sec. 605. Avoidance of duplicative or unnecessary analyses.
"Sec. 606. Effect on other law.
"Sec. 607. Preparation of analyses.
"Sec. 608. Procedure for waiver or delay of completion.
"Sec. 609. Procedures for gathering comments.
"Sec. 610. Periodic review of rules.
"Sec. 611. Judicial review.
"Sec. 612. Reports and intervention rights.

### "§ 601. Definitions

5 USC 601

"For purposes of this chapter—

"(1) the term 'agency' means an agency as defined in section 551(1) of this title; 5 USC 551

"(2) the term 'rule' means any rule for which the agency publishes a general notice of proposed rulemaking pursuant to section 553(b) of this title, or any other law, including any rule of general applicability governing Federal grants to State and local governments for which the agency provides an opportunity for notice and public comment, except that the term 'rule' does not include a rule of particular applicability relating to rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services, or allowances therefor or to valuations, costs or accounting, or practices relating to such rates, wages, structures, prices, appliances, services, or allowances; 5 USC 553

"(3) the term 'small business' has the same meaning as the term 'small business concern' under section 3 of the Small Business Act, unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register; 15 USC 632

"(4) the term 'small organization' means any not-for-profit enterprise which is independently owned and operated and is not dominant in its field, unless an agency establishes, after opportunity for public comment, one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register;

"(5) the term 'small governmental jurisdiction' means governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand, unless an agency establishes, after opportunity for public comment, one or more definitions of such term which are appropriate to the activities of the agency and which are based on such factors as location in rural or sparsely populated areas or limited revenues due to the population of such jurisdiction, and publishes such definition(s) in the Federal Register; and

"(6) the term 'small entity' shall have the same meaning as the terms 'small business', 'small organization' and 'small governmental jurisdiction' defined in paragraphs (3), (4) and (5) of this section.

5 USC 602.

### "§ 602. Regulatory agenda

Publication in Federal Register.

"(a) During the months of October and April of each year, each agency shall publish in the Federal Register a regulatory flexibility agenda which shall contain—

"(1) a brief description of the subject area of any rule which the agency expects to propose or promulgate which is likely to have a significant economic impact on a substantial number of small entities;

"(2) a summary of the nature of any such rule under consideration for each subject area listed in the agenda pursuant to paragraph (1), the objectives and legal basis for the issuance of the rule, and an approximate schedule for completing action on any rule for which the agency has issued a general notice of proposed rulemaking, and

"(3) the name and telephone number of an agency official knowledgeable concerning the items listed in paragraph (1).

Transmittal to SBA.

"(b) Each regulatory flexibility agenda shall be transmitted to the Chief Counsel for Advocacy of the Small Business Administration for comment, if any.

Notice.

"(c) Each agency shall endeavor to provide notice of each regulatory flexibility agenda to small entities or their representatives through direct notification or publication of the agenda in publications likely to be obtained by such small entities and shall invite comments upon each subject area on the agenda.

"(d) Nothing in this section precludes an agency from considering or acting on any matter not included in a regulatory flexibility agenda, or requires an agency to consider or act on any matter listed in such agenda.

5 USC 603.

### "§ 603. Initial regulatory flexibility analysis

Public comment. 5 USC 553.

"(a) Whenever an agency is required by section 553 of this title, or any other law, to publish general notice of proposed rulemaking for any proposed rule, the agency shall prepare and make available for public comment an initial regulatory flexibility analysis. Such analysis shall describe the impact of the proposed rule on small entities.

Publication in Federal Register. Transmittal to SBA.

The initial regulatory flexibility analysis or a summary shall be published in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule. The agency shall transmit a copy of the initial regulatory flexibility analysis to the Chief Counsel for Advocacy of the Small Business Administration.

"(b) Each initial regulatory flexibility analysis required under this section shall contain—

"(1) a description of the reasons why action by the agency is being considered;

"(2) a succinct statement of the objectives of, and legal basis for, the proposed rule;

"(3) a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply;

"(4) a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record;

"(5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule.

"(c) Each initial regulatory flexibility analysis shall also contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. Consistent with the stated objectives of applicable statutes, the analysis shall discuss significant alternatives such as—

"(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

"(2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities;

"(3) the use of performance rather than design standards; and

"(4) an exemption from coverage of the rule, or any part thereof, for such small entities.

5 USC 604.

### "§ 604. Final regulatory flexibility analysis

5 USC 553.

"(a) When an agency promulgates a final rule under section 553 of this title, after being required by that section or any other law to publish a general notice of proposed rulemaking, the agency shall prepare a final regulatory flexibility analysis. Each final regulatory flexibility analysis shall contain—

"(1) a succinct statement of the need for, and the objectives of, the rule;

"(2) a summary of the issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments; and

"(3) a description of each of the significant alternatives to the rule consistent with the stated objectives of applicable statutes and designed to minimize any significant economic impact of the rule on small entities which was considered by the agency, and a statement of the reasons why each one of such alternatives was rejected.

Public availability, publication in Federal Register. 5 USC 553.

"(b) The agency shall make copies of the final regulatory flexibility analysis available to members of the public and shall publish in the Federal Register at the time of publication of the final rule under section 553 of this title a statement describing how the public may obtain such copies.

5 USC 605.

### "§ 605. Avoidance of duplicative or unnecessary analyses

"(a) Any Federal agency may perform the analyses required by sections 602, 603, and 604 of this title in conjunction with or as a part of any other agenda or analysis required by any other law if such other analysis satisfies the provisions of such sections.

"(b) Sections 603 and 604 of this title shall not apply to any proposed or final rule if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. If the head of the agency makes a certification under the preceding sentence, the agency shall publish such certification in the Federal Register, at the time of publication of general notice of proposed rulemaking for the rule or at the time of publication of the final rule, along with a succinct statement explaining the reasons for such certification, and provide such certification and statement to the Chief Counsel for Advocacy of the Small Business Administration.

Certification, publication in Federal Register and transmittal to SBA

"(c) In order to avoid duplicative action, an agency may consider a series of closely related rules as one rule for the purposes of sections 602, 603, 604 and 610 of this title.

5 USC 606.

### "§ 606. Effect on other law

"The requirements of sections 603 and 604 of this title do not alter in any manner standards otherwise applicable by law to agency action.

5 USC 607.

### "§ 607. Preparation of analyses

"In complying with the provisions of sections 603 and 604 of this title, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.

5 USC 608.

### "§ 608. Procedure for waiver or delay of completion

Publication in Federal Register.

"(a) An agency head may waive or delay the completion of some or all of the requirements of section 603 of this title by publishing in the Federal Register, not later than the date of publication of the final rule, a written finding, with reasons therefor, that the final rule is being promulgated in response to an emergency that makes compliance or timely compliance with the provisions of section 603 of this title impracticable.

Publication in Federal Register.

"(b) Except as provided in section 605(b), an agency head may not waive the requirements of section 604 of this title. An agency head may delay the completion of the requirements of section 604 of this title for a period of not more than one hundred and eighty days after the date of publication in the Federal Register of a final rule by publishing [illegible] the Federal Register, not later than such date of publication, [illegible] written finding, with reasons therefor, that the final rule is being promulgated in response to an emergency that makes timely compliance with the provisions of section 604 of this title impracticable. If the agency has not prepared a final regulatory analysis pursuant to section 604 of this title within one hundred and eighty days from the date of publication of the final rule, such rule shall lapse and have no effect. Such rule shall not be repromulgated until a final regulatory flexibility analysis has been completed by the agency.

5 USC 609.

### "§ 609. Procedures for gathering comments

"When any rule is promulgated which will have a significant economic impact on a substantial number of small entities, the head of the agency promulgating the rule or the official of the agency with statutory responsibility for the promulgation of the rule shall assure that small entities have been given an opportunity to participate in the rulemaking for the rule through techniques such as—

"(1) the inclusion in an advanced notice of proposed rulemaking, if issued, of a statement that the proposed rule may have a significant economic effect on a substantial number of small entities;

"(2) the publication of general notice of proposed rulemaking in publications likely to be obtained by small entities;

"(3) the direct notification of interested small entities;

"(4) the conduct of open conferences or public hearings concerning the rule for small entities; and

"(5) the adoption or modification of agency procedural rules to reduce the cost or complexity of participation in the rulemaking by small entities.

5 USC 610

### "§ 610. Periodic review of rules

Plan, publication in Federal Register.

"(a) Within one hundred and eighty days after the effective date of this chapter, each agency shall publish in the Federal Register a plan for the periodic review of the rules issued by the agency which have or will have a significant economic impact upon a substantial number of small entities. Such plan may be amended by the agency at any time by publishing the revision in the Federal Register. The purpose of the review shall be to determine whether such rules should be continued without change, or should be amended or rescinded, consistent with the stated objectives of applicable statutes, to minimize any significant economic impact of the rules upon a substantial number of such small entities. The plan shall provide for the review of all such agency rules existing on the effective date of this chapter within ten years of that date and for the review of such rules adopted after the effective date of this chapter within ten years of the publication of such rules as the final rule. If the head of the agency determines that completion of the review of existing rules is not feasible by the established date, he shall so certify in a statement published in the Federal Register and may extend the completion date by one year at a time for a total of not more than five years.

Consideration factors.

"(b) In reviewing rules to minimize any significant economic impact of the rule on a substantial number of small entities in a manner consistent with the stated objectives of applicable statutes, the agency shall consider the following factors—

"(1) the continued need for the rule;

"(2) the nature of complaints or comments received concerning the rule from the public;

"(3) the complexity of the rule;

"(4) the extent to which the rule overlaps, duplicates or conflicts with other Federal rules, and, to the extent feasible, with State and local governmental rules; and

"(5) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.

Publication in Federal Register.

"(c) Each year, each agency shall publish in the Federal Register a list of the rules which have a significant economic impact on a substantial number of small entities, which are to be reviewed pursuant to this section during the succeeding twelve months. The list shall include a brief description of each rule and the need for and legal basis of such rule and shall invite public comment upon the rule.

5 USC 611

### "§ 611. Judicial review

"(a) Except as otherwise provided in subsection (b), any determination by an agency concerning the applicability of any of the provisions of this chapter to any action of the agency shall not be subject to judicial review.

"(b) Any regulatory flexibility analysis prepared under sections 603 and 604 of this title and the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review. When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review.

"(c) Nothing in this section bars judicial review of any other impact statement or similar analysis required by any other law if judicial review of such statement or analysis is otherwise provided by law.

**Submittal to President and congressional committees.**
**5 USC 612.**

**"§ 612. Reports and intervention rights**

"(a) The Chief Counsel for Advocacy of the Small Business Administration shall monitor agency compliance with this chapter and shall report at least annually thereon to the President and to the Committees on the Judiciary of the Senate and House of Representatives, the Select Committee on Small Business of the Senate, and the Committee on Small Business of the House of Representatives.

"(b) The Chief Counsel for Advocacy of the Small Business Administration is authorized to appear as amicus curiae in any action brought in a court of the United States to review a rule. In any such action, the Chief Counsel is authorized to present his views with respect to the effect of the rule on small entities.

"(c) A court of the United States shall grant the application of the Chief Counsel for Advocacy of the Small Business Administration to appear in any such action for the purposes described in subsection (b).".

### EFFECTIVE DATE

**5 USC 601 note.**

SEC. 4. The provisions of this Act shall take effect January 1, 1981, except that the requirements of sections 603 and 604 of title 5, United States Code (as added by section 3 of this Act) shall apply only to rules for which a notice of proposed rulemaking is issued on or after January 1, 1981.

Approved September 19, 1980.

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LEGISLATIVE HISTORY:

SENATE REPORT No. 96-878 (Comm. on the Judiciary).
CONGRESSIONAL RECORD, Vol. 126 (1980):
    Aug. 6, considered and passed Senate.
    Sept. 8, 9, considered and passed House.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 16, No. 38:
    Sept. 19, Presidential statement.

## APPENDIX V

## RECOMMENDED ACTIONS TO IMPROVE THE REGULATORY FLEXIBILITY ACT: AND SUBSEQUENT REGULATORY PROCESS FOR SMALL COMMUNITIES

There are a number of ways in which the regulatory flexibility process could be improved to benefit small communities. Some of these improvements require congressional authorization, some would need only administrative action, while others may require congressional approval and administrative action.

The National Association of Towns and Townships (NATaT) strongly recommends that Congress and the Administration consider the following actions to strengthen and improve the regulatory process, so that small communities have a realistic chance to conform with federal policies:

1. Change the population threshold currently used in the Regulatory Flexibility Act from the present "with a population less than 50,000" to categories of population as follows: 50,000 to 25,000; 25,000 to 10,000; 10,000 to 5,000; with special effort made by federal agencies to include analyses for communities of 5,000 people or less;

2. Create an Office of Advocacy for Small Entities in each federal agency similar to the Small and Disadvantaged Business Office currently within the Environmental Protection Agency, which would be appointed by and report directly to the head of the agency. The advocate would be enpowered to review and analyze all regulatory actions under consideration by the agency and would provide information and assistance to small entities to ensure that small governments' comments were solicited and addressed.

   Federal agencies would be required to provide resources and staff members commensurate with the responsibilities noted above, and no advocate could be fired without cause.

3. Hold federal agency heads accountable for conducting regulatory flexibility analysis by requiring that agencies prove through documentation that they have conducted the analysis required under the law and direct federal agencies to publish their documentation as a matter of public record. When federal agency heads certify that a particular regulation "has no substantial impact for a significant number of small entities," the agency should be required to publish as a matter of public record, how such determination was made, who conducted the analysis, and what organizations or small governments were solicited as part of the analysi process.

4. Agencies should be required to separate governments and small businesses in conducting their regulatory flexibility analysis;

5. When a federal agency head utilizes the certification provision under the Regulatory Flexibility Act, the Small Entity Advocate should be consulted in the process, and his or her comments should be included in the agency's announcement of its certification as matter of public record;

6. Federal agency personnel should be required to go well beyond present efforts to seek comments from small entities, soliciting comments through regional offices, representative national organizations, and state organizations representing small entities;

7. Interpretative rules should be covered under the Act;

8. More extensive judicial review under the Act's provisions should be considered.

We urge Congress and the Administration to consider these improvements to the Regulatory Flexibility Act. Their adoption would ensure that small governments have a realistic opportunity to carryout federal policies since these improvements would premise agency regulatory procedures on what is possible as opposed to what is ideal. Without such encouragements, we increasingly find officials from small localities simply cannot comply.

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